

FIRST PART
EVALUATION OF THE MONETARY,
EXCHANGE RATE AND CREDIT POLICY
TO NOVEMBER 2005

I. QUALITATIVE ASPECTS

The Monetary Board, in resolution JM-160-2004 dated December 29, 2004, determined the Monetary, Exchange rate and Credit policy for 2005, designed to continue with the process of adoption of a complete scheme of explicit inflation goals and oriented to consolidating the stability and confidence in the main macroeconomic and financial variables. In that sense, the fundamental objective of the referred policy was specified as an inflation goal for the end of the year established in a range between 4% and 6%, as well as the maintenance of said range for the twelve following months.

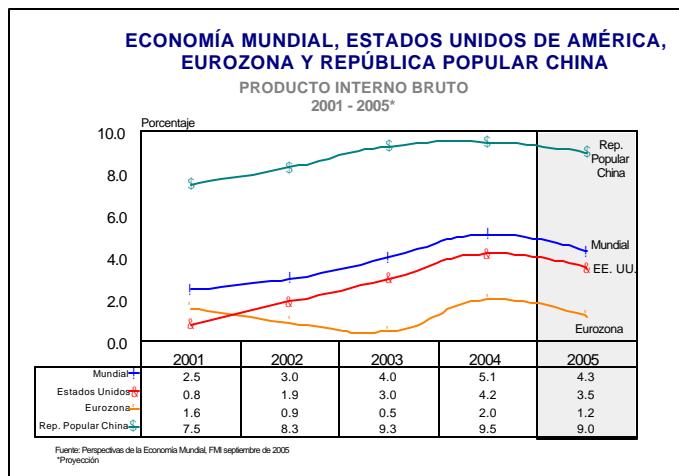
The implementation of the monetary policy in 2005 has been consistent with the efforts of advancing in the adoption of an integral scheme of explicit inflation goals, that are founded on the election of the inflation goal like the nominal anchor of the economy and is consolidated with the implementation of a regimen of a flexible exchange rate, with the use of instruments of indirect monetary control (operations of monetary stabilization, giving privilege to the market decisions), like the perfectionism of the transparency of the actions of the Central Bank, all of which would allow to continue consolidating the stability and trust in the macroeconomic and financial variables.

In the described context, to November, 2005 the inflationary rhythm was at 9.25%, similar to December, 2004 (9.23%). If during the present year the deflation process could not materialize, the inflation rate did not increase, notwithstanding the adverse incidence of exogenous factors, like the continuous rise in international oil prices and the effect of tropical storm Stan, as well as the complications of the execution of the policy continued being observed derived of the flow of capital that coincided with the tendency toward appreciation of the nominal exchange rate. The above was possible due to the prudent and disciplined application of the monetary policy, supported by the fiscal policy behavior.



Graph No. 1

World Economy, United States of America, Euro Zone, and
People's Republic of China
Gross Internal Product 2001-2005



International Environment. As to the external conditioners of the monetary policy, it was observed that during the course of the year **the rise in international oil prices** continued being, as was indicated, one of the main factors that explains the behavior of the inflationary rhythm, just like it did during 2004. As a consequence, in 2005 the inter-annual variation of the general level of prices did not decelerate in the manner foreseen at the end of the previous year.

On the other hand, after the growth of **world economy** in 2004 of 5.1% (the highest rate of the last twenty years); it was foreseen that in 2005 it would grow 4.3%, rate that still represents a high dynamism of the global economy. Said behavior is sustained, on the one hand, in the economic growth revolution of the United States of America, the main commercial partner of the country, that is estimated will register an economic growth rate of 3.5%¹, sustained in a solid increase of the productivity, that is added to the proper conditions in the financial markets and an increase in the housing sector, all which has allowed a cushion to the losses and damages caused by hurricanes *Katrina* and *Rita* and, on the other hand, the behavior of the economy of the People's Republic of China, which, notwithstanding the measures of macroeconomic restriction implemented in 2005 and the exchange reform, that included the reevaluation of the *renmibi* of 2.1% and a broad daily fluctuation of the same of 0.3% before the US dollar, continues registering important growth, that is estimated at 9.0% for 2005, lower to the observed in 2004 (9.5%).

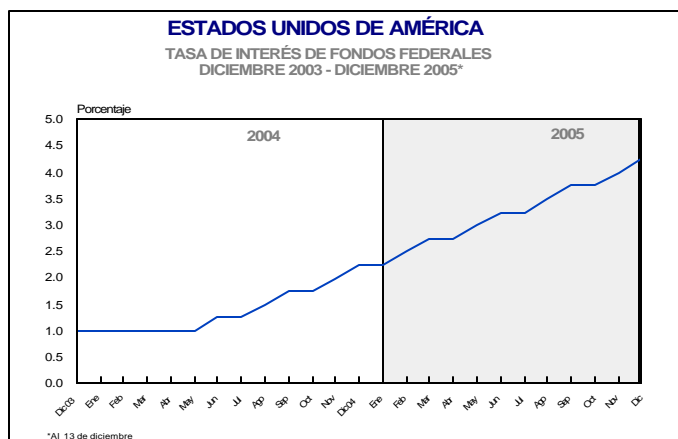
¹ According to the IMF, in 2005, "the growth of the economic activity of the United States will continue to be higher between the G-7 members"... IMF, World Economic Outlook, September 2005, page 9.



In the described environment, it is worth indicating that the International Monetary Fund (IMF) estimates that risks persist that could threaten world economic growth, among them are:

- i) Global expansion that is not balanced therefore will continue to depend on the economic performance of the United States and the People's Republic of China. With the highlighted exceptions of Japan and India, the growth projections have been revised toward the low for almost all other regions during 2005. In that sense, the ever greater weakening of the Euro Zone is worrying, since it has not had the expected performance, due to the weakening of the domestic demand of its exportations. In that sense, it is indicated that if this situation were to continue, it could increase global imbalances and accentuate the possibilities of a later significant deceleration, especially if the growth in the United States of America and in the People's Republic of China were to weaken simultaneously;
- ii) The possibility of an abrupt rise in the long term interest rates, in case significantly restrictive conditions were given in financial markets, would adversely affect the domestic demand;
- iii) The high oil prices and the vulnerability of said market to shocks, continues being a preoccupation – exacerbated by the catastrophic effects of hurricanes *Katrina and Rita*, which is a negative weight factor, each time greater;
- iv) The global imbalances – one of the greatest risks for the perspective in the mid term- have grown stronger again. For example, in the United States, the deficit in current account of the payments balance will increase in more than 6% of the GNP according to the projections for 2005 (0.3% of the GNP greater than the foreseen in the first semester) a cause, among others, of the rising prices of oil and of the constant solidity of the internal demand;
- v) The threat of the macroeconomic stability in the mid term that the fiscal projections suppose in many countries, particularly the fiscal deficits of the majority of the industrialized economies; and,
- vi) The structural weaknesses that limit the growth in key areas and increase the vulnerability before the shocks, like the need to accelerate the reform in the work markets and productivity in the Euro zone and the strengthening of the investment climate in Latin America.

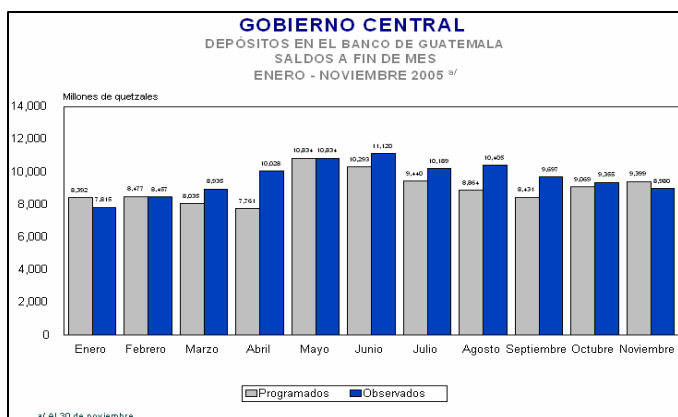
Graph No. 2
United States of America
Federal Funds Interest Rates
December 2003 to December 2005



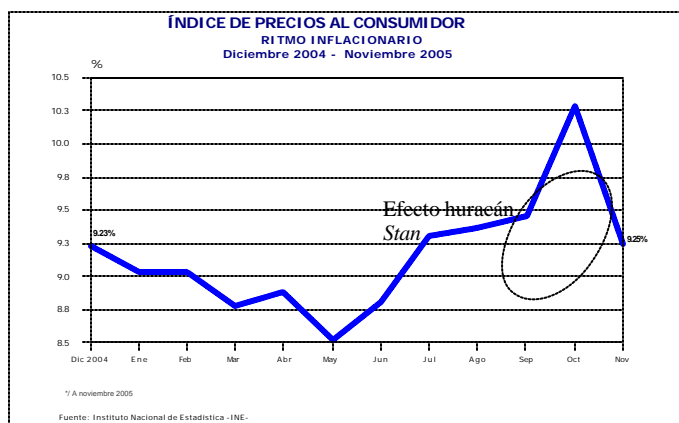
Regarding the **macroeconomic policy in the United States**, it continues with the fragility derived of the significant fiscal deficit and in the current account of the payments balance. As to the public finances, for the fiscal period of October 2004 – September 2005 the deficit was at 2.6% of the GNP, still very elevated. On the other hand, the deficit in current account of the payments balance of the United States is foreseen that at the end of 2005 will be at 6.1% as a portion of the GNP, which could require an adjustment in the exchange rate as well as the restriction in public expense.



Graph No. 3
Central Government
Deposits in the *Banco de Guatemala*
Balances at the end of the month



Graph No. 4
Consumer Price Index, Inflationary Rhythm
December 2004 to November 2005



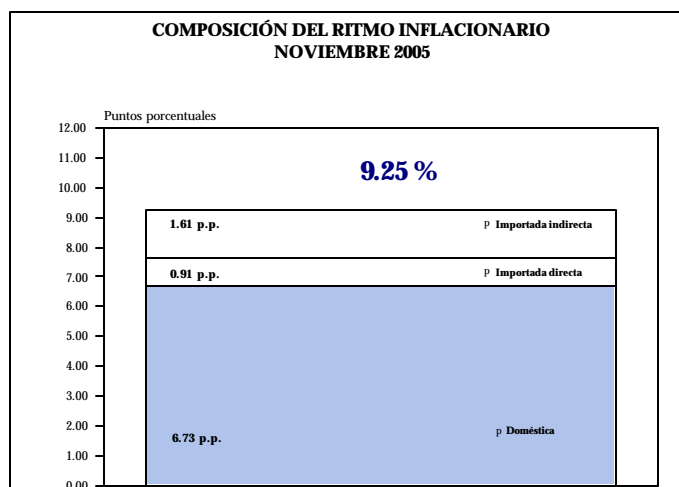
Regarding the monetary policy, to December, 2005 the authorities of the Federal Reserve will continue increasing the objective interest rate of federal funds, which during the year happened on eight occasions, with increases in 25 basic points in each one of them; elevating it to 2.25% in January, to 4.25% in December. These adjustments, that have allowed keeping the general level of prices under control, combined with the increase in the international oil prices; it still has not had the adverse effect in the economic activity of the United States, therefore the estimation of growth of 3.5% has been kept during the present year.

Internal Environment. On the one hand, in the internal order it has been important to offer support from the fiscal policy to the monetary policy, through the maintenance of a level of deposits in the *Banco de Guatemala* above the programmed; the demonetizing behavior of the rest of the public sector reflected in greater demand of the LTDs of the *Banco de Guatemala*; and, the formation of positive economic growth expectations, derived not only from the cited behavior of the global economy, but also of the consolidation of the governmental operation.

Inflation. To November 2005, the inflationary rhythm, in the frame of the execution of monetary policies and disciplined fiscal policies, increased 0.02 percentage points, when surpassing 9.23% in December 2004 to 9.25% in November 2005. Notwithstanding, during the year said variable showed fluctuations mainly due to the volatility of the international price of oil and, additionally, the increase in the prices, at one time, associated to tropical storm *Stan*.



Graph No. 5
Composition of the Inflationary Rhythm
November 2005



According to the estimations of the technical departments of the *Banco de Guatemala*, the behavior of the inflation to November can be separated into its imported and domestic components. In that sense, the inflationary rhythm observed to November 2005 (9.25%), 2.52 percentage points are attributed to the imported inflation, of which, 1.61 percentage points correspond to the indirect imported inflation (second round effect), so that of the total inflationary rhythm, 6.73 percentage points correspond to the domestic inflation.

Additionally, it is worth indicating that in October, 2005 the country was affected by tropical storm Stan, which originated difficulties in the distribution of agricultural goods, which generated a temporary lack of provisions of some products, aspect which affected the consumer price index, on the one hand, registering an increase in October of 1.76%, which was the highest since hurricane Mitch in 1998 and, on the other hand, exhibited an inflationary rhythm of 10.29%. It is worth indicating that the increase in the inflation of October, 1.01 percentage points corresponded to the inflationary effect of tropical storm *Stan*.

The inflationary rhythm in 2005 has not been of the foreseen magnitude, due to the fact that the international price of the barrel of oil, which had been estimated by the international financial markets that in 2005 would be kept, in average, at US\$42.38, during the year registering a tendency toward the rise, has reached a historic record on August 30 of US\$69.81, to later level off at around US\$60.00 per barrel.



EVOLUTION OF THE INTERNATIONAL PRICE OF OIL IN 2005 (TO NOVEMBER 30)

In 2005, a persistent tendency toward the rise of the international price of oil was registered, which located itself at record levels in various opportunities, having reached, as was indicated, on August 30 the greatest historic closing price ever observed in the New York Stock Exchange of US\$69.81 per barrel. The referred tendency toward the rise was provoked by the combination of lack of elasticity of the world offer regarding the price and the increase in the consumption on behalf of the United States of America and the People's Republic of China, phenomenon which has generated that the world supply and demand of crude oil keep very close levels, such as is appreciated in the following:

WORLD SUPPLY AND OIL DEMAND					
Millions of barrels per day					
OFFER		Mar-05	Jun-05	Sep-05	Oct-05
	OPEP 1/	34.2	34.5	35.0	34.5
	NO OPEP	50.1	50.1	49.0	47.9
	TOTAL OFFER	84.4	84.6	84.1	86.2
DEMAND	OECD 2/	49.8	49.8	49.1	49.5
	REST OF THE WORLD	34.5	34.5	33.6	33.5
	TOTAL DEMAND	84.3	84.3	82.7	83.0
	BALANCE	0.1	0.3	1.4	3.2

1/ Organization of exporting countries of oil (11 producing countries)

2/ Organization for Economic Cooperation and Development (30 industrialized countries)

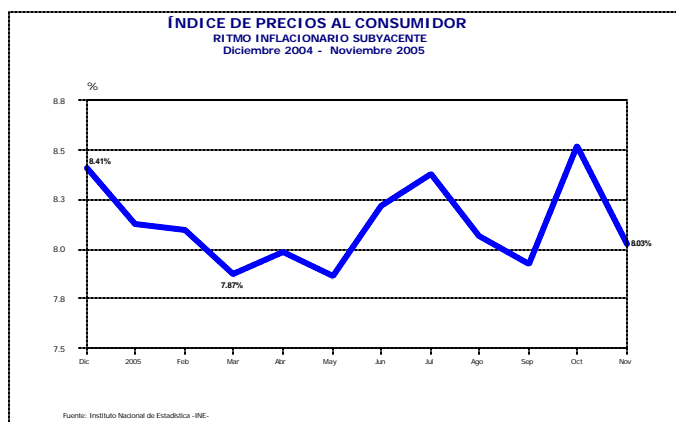
In the context of hurricanes Katrina and Rita, the international price reached record levels. In that context the stabilization of prices was possible, due to the following: 1) with the objective of increasing the level of offer, the International Energy Agency placed part of the strategic reserves on the market and later, having concluded the necessary repairs, the oil installations of the Gulf of Mexico began production slowly, increasing the level of the world offer of crude oil until it reached the prior level to the cited natural phenomenon; and, 2) simultaneously began to observe a deceleration in the consumption on behalf of the United States and the People's Republic of China, propitiated by the high level of prices that the crude oil had reached, which generated that after September it would descend, tendency which remained until November 30 of the current year.

^{1/} Source: Global Insight

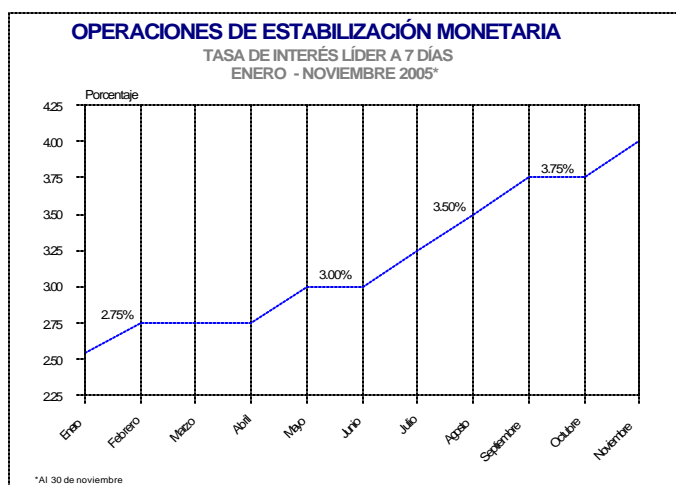
It is important to emphasize that, if the inflation has an important exogenous component of imported nature, before which the monetary policy can not be influenced, this can affect the domestic inflation, which still presents a rate of 6.73%, therefore, the fundamental objective of the Central Bank is the stability in the general level of prices, and taking into account that the level in which the inflationary rhythm is found, it is important that in 2006 they continue taking action in the monetary policy that allows the deceleration in the referred variable. In this manner, it contributes to the creation of an environment of certainty and trust that cooperates in maintaining the acquisition power of the population and to generating productive investment and, therefore, greater levels of employment and well-being.



Graph No. 6
Consumer Price Index
Subjacent Inflationary Rhythm
December 2004-November 2005



Graph No. 7
Monetary Stabilization Operations Leading Interest Rate at 7 days



The behavior of the international price of oil has affected, as was indicated, in the behavior of the inflationary rhythm. The last econometric projection made, that already incorporates the behavior of the rise in prices of crude oil to November 30, 2005, indicates that for December of the current year the inflationary rhythm is at 9.19%, above the fixed range goal for the end of the year by the Monetary Board (4% - 6%). Therefore, given that the behavior of the general level of prices still responds to a phenomenon of exogenous nature, the necessary policy measures must be taken that allow reducing the second round effects of imported inflation, in order to allow that the total inflation decelerate gradually, consistently with the inflation goal that is established in the Monetary, Exchange rate and Credit Policy to be determined by the Monetary Board for 2006.

On the other hand, the subjacent inflationary rhythm surpassed 8.41% in December, 2004 to 8.03% in November, 2005 (reduction of 0.38 percentage points), which suggests that the adjustments to the interest rate of monetary stabilization operations, implemented in 2004 and in 2005, supported by the fiscal discipline, have cooperated in containing the behavior of said variable.

Last, in a scenario that considers that the international oil price is kept close to US\$60.00 per barrel- is expected, taking into account the econometric projections of the technical departments of the *Banco de Guatemala* that the inflationary rhythm for December 2005 is at 9.19%.

Execution of the Monetary Policy. During 2005, the operation of the monetary policy was oriented toward the measures that allow cooperation in the deceleration in the inflationary rhythm. In that sense, the Execution Committee of the *Banco de Guatemala*, with the purpose of placating the inflationary expectations of the economic agents and of sending messages of certainty on the promise of the Central Bank to continue watching over the stability in the general level of prices, increased the leading interest rate of the monetary policy on six occasions². Also, with the end of increasing the effectiveness of the monetary policy, and according to the guidelines of the Monetary Board, adopted stocks for the improvement of its operative

² February 18 (from 2.55% to 2.75%), May 20 (from 2.75% to 3.00%), July 22 (from 3.00% to 3.25%), August 19 (from 3.25% to 3.50%), September 16 (from 3.50% to 3.75%) and November 18 (from 3.75% to 4.00%)

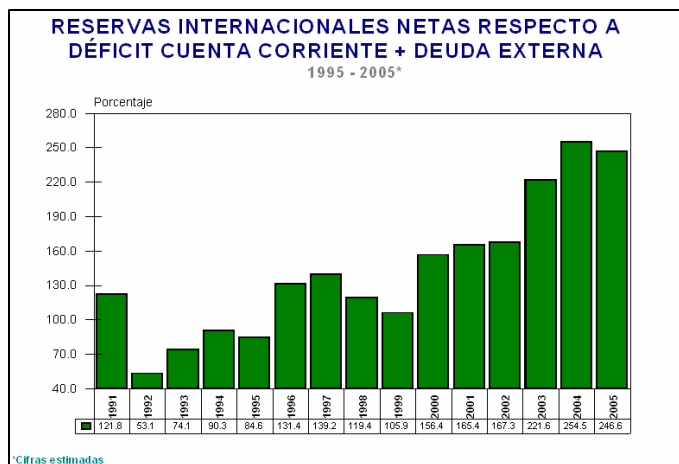


procedures, oriented toward the advancement in the process of adoption of a complete monetary scheme of explicit inflation goals (*Inflation Targeting*). As to the operations of monetary stabilization, in 2005 were adopted, among others, the following measures: i) fixing of an only leading interest rate for the operations of monetary stabilization in the short term (LTDs in 7 day terms); ii) calendarization of the decisions of the Execution Committee regarding the changes in the leading interest rate at a later date closer to the 15th of each month; iii) reduction of the number of biddings; and iv) fixing of the quotas for fund raising of LTDs that is placed for the bidding mechanism.

As to the exchange market, the *Banco de Guatemala* participated in the same applying the explicit rule, in order to eliminate the discretionary participation and reducing the volatility of the exchange rate, without modifying its tendency. When applying said rule, the *Banco de Guatemala* bought US\$466.6 million between January and August, 2005 (last day of participation, August 11).

Due to the above, the net international reserves – NIR–, to November 30, was at US\$3,766.4 million, amount greater by US\$238.4 million at the level registered to December 31, 2004 and that represents 4.7 months of importations of commodities and 4.9 times the amount of the service of the public external debt in a year, indicators note the solidity of the external position of the country. On its part, if the monetary reserves are related with other monetary variables, it is declared that the NIR represent 1.5 times of the monetary base, whereas the NIR as a percentage of money supply in the widest sense (M2) represent, to November 30, 2005, 41.6%, which suggests that the country counts on a reasonable margin for covering the monetary obligations converted to foreign currency. Another indicator of the external position of the country³ is given due to the relation of the level in the NIR regarding the sum of the deficit in the current account of the payments balance and of the payments of the foreign public debt per year, whose results would indicate that with the current NIR level could cover up to 2.5 times the referred obligations.

Graph No. 8
Net International Reserves regarding the
current account deficit + external debt



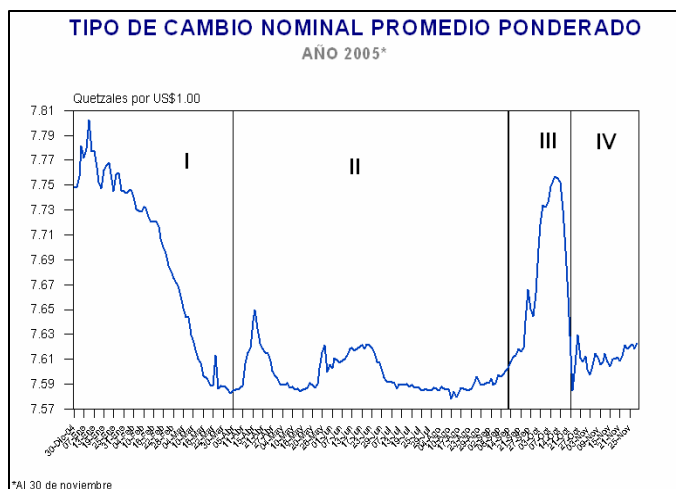
³ Without considering the payments of private foreign debt in one year



The type of nominal exchange rate was quoted at Q7.75 per US\$1.00 on December 30, 2004 and to November 30, 2005 was quoted in the foreign currency market at Q7.62 per US\$1.00. Said behavior could be divided in four periods; the first between December 30, 2004 and April 5, 2005, in which the exchange rate appreciated Q0.17 (2.19%) when going from Q7.75 per US\$1.00 to Q7.58 per US\$1.00; the referred behavior is mainly associated to the world phenomenon of depreciation of the dollar of the United States (derived from the relaxing of the fiscal and monetary policies that said country applied in the recent past), that propitiated a capital income of emerging economies. In the second period, from April 5 to September 13, 2005, the nominal exchange rate was observed to stop appreciating, since it went from Q7.58 per US\$1.00 to Q7.60 per US\$1.00; in other words, a depreciation of Q0.02 (0.26%). Said behavior can be associated to diverse factors of seasonal factors as well as the application of the exchange rule on behalf of the Central Bank and, particularly a decrease in the income of capital toward the country, in part derived of the reduction of the differentials between the internal and external interest rates, which at the same time obeys the increase in the objective interest rate of federal funds on behalf of the Federal Reserve of the United States; in the third period, from September 14, to October 14, the exchange rate went from Q7.61 per US\$1.00 to Q7.75 per US\$1.00, registering a behavior of high volatility, associated among other factors, to the demand of foreign currency from fuel importing companies. The last period spans from October 17 up to November 30, in which the exchange rate went from Q7.75 per US\$1.00 to Q7.62 per US\$1.00, appreciation that obey mainly to the seasonality of the variable.

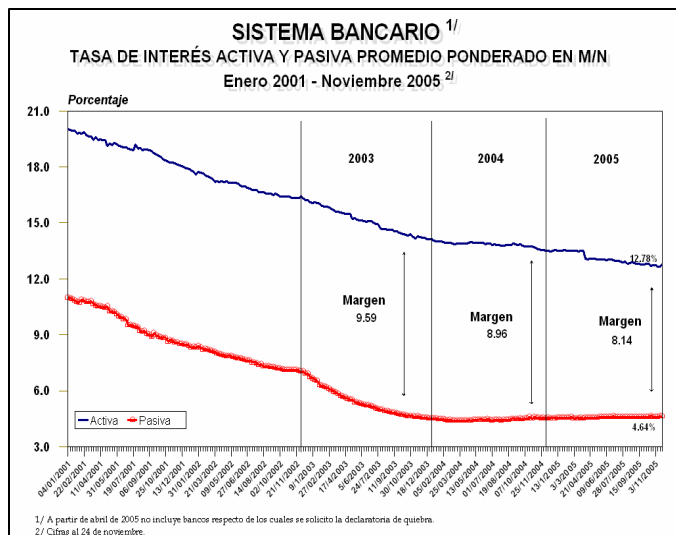
Graph No. 9

Weighted Average Nominal Exchange Rate



Graph No. 10
Banking System

Weighted Average of Interest Rate of Assets and Liabilities in M/N

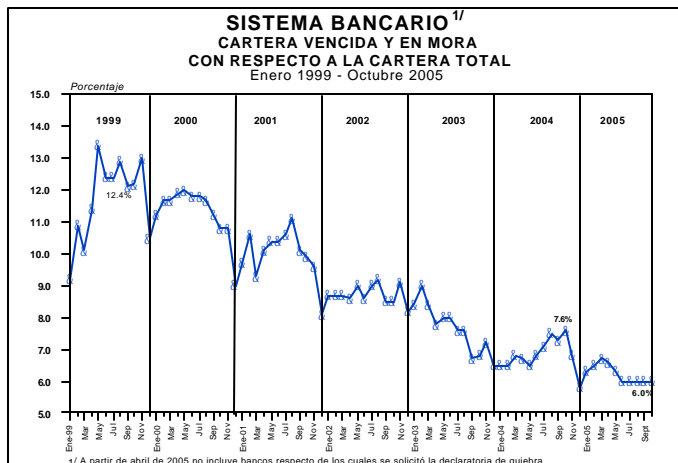


Financial Sector. During 2005, the financial sector continued operating in an environment characterized by the stability of the interest rate, the credit expansion, the improvement in the quality of the portfolio and the reduction of the unproductive assets.

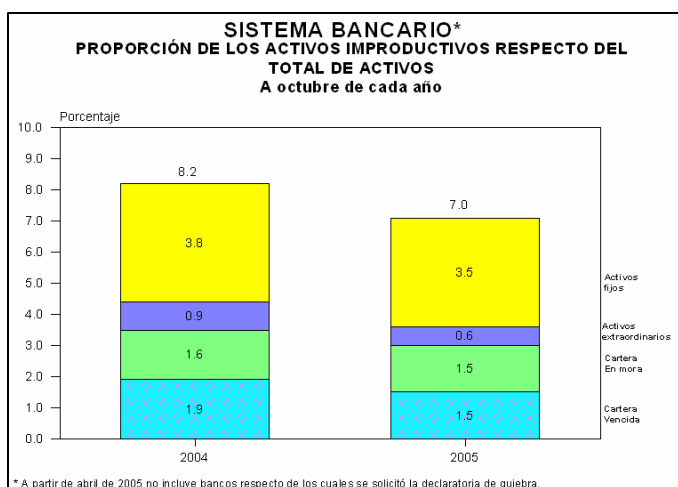
The weighted average interest rates in national currency of the banking system showed a stable tendency, due to the fact that since December 2004 to November 24, 2005 the asset rate went from 13.50% to 12.78%, whereas the liability rate went from 4.54% to a 4.64%. The weighted average interest rate of the repurchase agreements operations also showed stability, between January and November, in average around



Graph No. 11
Banking System
Expired and Late Portfolio
regarding the entire portfolio



Graph No 12.
Banking System
Proportion of the Unproductive Assets regarding the total assets to
October of each year



2.7%, behavior that reflects the conditions in the short term of the financial market.

The banking credit to the private sector from November 24, showed an inter-annual growth rate of 21.3%, which is located over the range foreseen for that date, according to the seasonality of that variable⁴. The most important heading of the banking credit to the private sector is made up of the credit portfolio, which, without including the banks who were required to declare bankruptcy, showed to October 31, 2005 (last available information), an inter-annual growth of 22.3%, observing that the greater part of said portfolio (89.7%), is concentrated in the consumer and transfers, commerce, construction, industry and agriculture sections.

Regarding the quality of the credit portfolio, it is observed that the proportion of the contaminated portfolio (late portfolio plus the expired portfolio) regarding the total credit portfolio of the banking system, excluding the portfolio of banks regarding those who were required to declare bankruptcy, have demonstrated a slight reduction. To October 31, 2005 said portfolio represented 6.0% of the total portfolio of the banking system, lower by 1.6 percentage points to the observed on the same date as the previous year (7.6%).

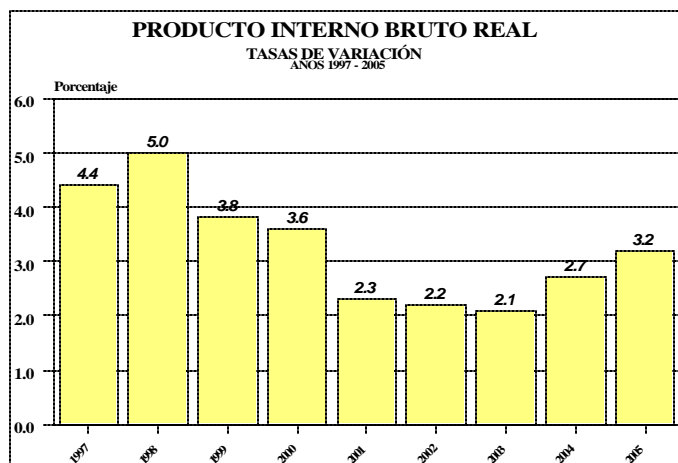
On the other hand, the indicator of unproductive assets of the banking system (integrated by the contaminated portfolio, the extraordinary assets and the fixed assets), as a proportion of the total assets, also reflects an improvement, since it continued showing a tendency toward the low at 7.0% in October, 2005, percentage which is inferior to the registered on the same date the year before (8.2%).

Situation of the Public Finance. The fiscal policy is conducted with prudent, supporting the efforts of consolidation of macroeconomic stability. In that sense, the primary deficit is expected to be located within the range of sustainability of the public finances, which has been estimated in a range of +/- 0.5% of the GNP⁵. Consistent with that, the indicators of solvency of the external public debt and total public debt is found

⁴ The increase in total credit to the private sector over the upper limit of its estimated running, began evidencing itself in the second week of the month of July, 2005, situation which is associated, on the one hand, to the effect that was derived of its credits that extraordinarily granted some banks, whose relative weight is important in the financial intermediation of the country.

⁵ According to Sebastián Edwards and Rodrigo Vergara in their document "Monetary Policy and Macroeconomic Stability in Guatemala", November 2004.

Graph No. 13
Real Gross Internal Product
Variation Rate



below the levels considered as critical. In that context, the efforts increase their tributary load allowing the configuration of a fiscal scenario that supports the macroeconomic stability in the long term.

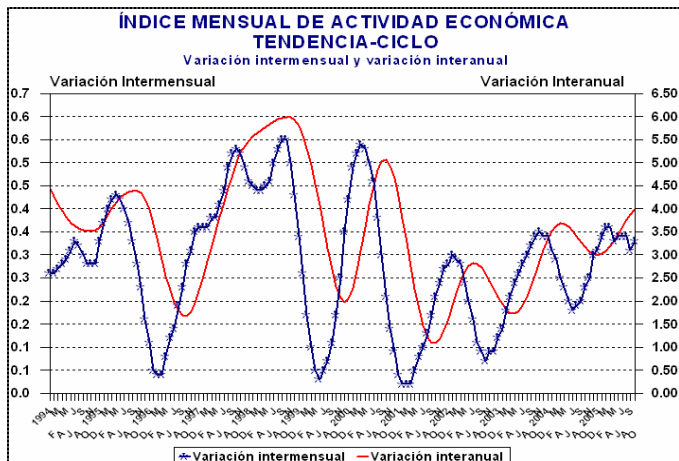
To November 30, 2005, according to the preliminary numbers of the *Ministerio de Finanzas Públicas* [Equivalent to the Department of Economy], there was observed a fiscal deficit of Q1, 872.1 million (fiscal deficit of Q1, 229.2 million to November, 2004). This result obeys the greater dynamics observed in public expense, since it increased by Q2, 440.8 million (11.1%); while the total income is increased by Q1, 797.9 million (8.7%). The greater dynamics showed in the expenditure, obeying a greater impulse of capital expense, which registered an increase by Q1, 064.8 million (17.3%).

On the other hand, it is worth indicating that the increase in the deposits that the central government has in the *Banco de Guatemala* were substantially greater than those that had been programmed for the period of January to November, which was constituted in important support of the fiscal policy to the monetary. Said behavior contributed to neutralizing the monetizing effect derived of the purchase of foreign currency of the Central Bank in the exchange market for moderating the volatility of the nominal exchange rate.

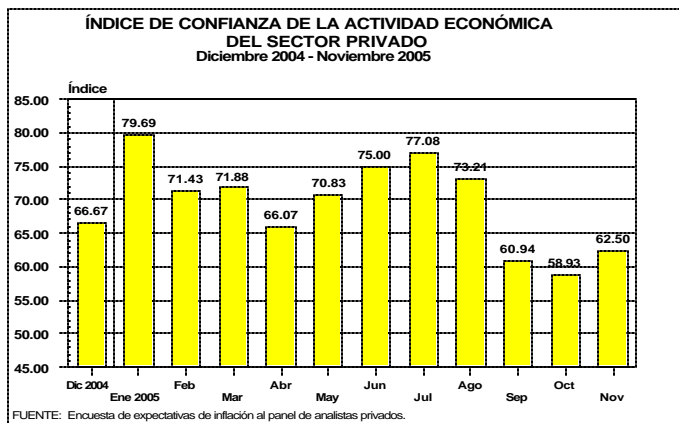
The maintenance of the fiscal discipline is fundamental for the consolidation of the macroeconomic stability, as well as to create an environment of certainty and confidence, in which the economic agents make adequate decisions in consumption matters, savings and investment, factors that are fundamental for propitiating growth and development ordered of the national economy.

Real Sector. The deceleration that the growth rhythm of the national economic activity manifested since 1999, reverted in 2004, tendency that continued in 2005, year for which the Gross National Product – GNP- is estimated in real terms will grow 3.2% (2.7% in 2004). It is worth indicating that this growth rate, although positive, continues being inferior to the average rate registered in the decade of the nineties (4.1%), but higher for the second consecutive year to the population growth rate (2.5%). Said behavior is founded, in the external order, in the favorable growth

Graph No. 14
Monthly Index of Economic Activity
Tendency – Cycle
Inter-monthly and inter-annual variation



Graph No. 15
Index of Trust of the Economic Activity
of the Private Sector
December 2004 – November 2006



that is foreseen in the United States economy as well as for the rest of the main commercial partners of Guatemala; and in the internal order, in the maintenance of the macroeconomic stability, based on the application of monetary and fiscal disciplined policies⁶.

If the international oil price for the second year constituted an adverse factor of the national productive activity, the impulse that continues showing the world economy, fundamentally sustained in the economic growth of the United States and the People's Republic of China, of supporting the expected growth of the Guatemalan economy. In that sense, even though the increase in the international oil price has been transferred to the general level of prices, it has not yet lessened the impulse of the national economic activity.

The tendency-cycle of the Monthly Index of the Economic Activity -IMAE- (for its acronym in Spanish), after registering a deceleration between May 2004 to January 2005, as of February began showing a growing behavior.

According to the tendency of the Trust Index of the Economic Activity of the Panel of Private Analysts⁷, the expectations of economic reactivation during the first eight months of 2005 were kept above the registered in December 2004. In contrast, in the later months, from September to November the referred index was located below the observed level in December of the previous year even though in the month of November it was observed that it began to recover.

Another indicator that is obtained from the panel of private analysts is the one regarding the estimation of growth of the GNP. In that respect, said analysts foresee that the national economic activity will increase its growth rhythm in 2005 to a rate of 3.0% (2.8% in

⁶ It is estimated that tropical storm *Stan* had an unappreciable effect on the production flow of the country that was computed according to the methodology with which the national accounts of the country are computed.

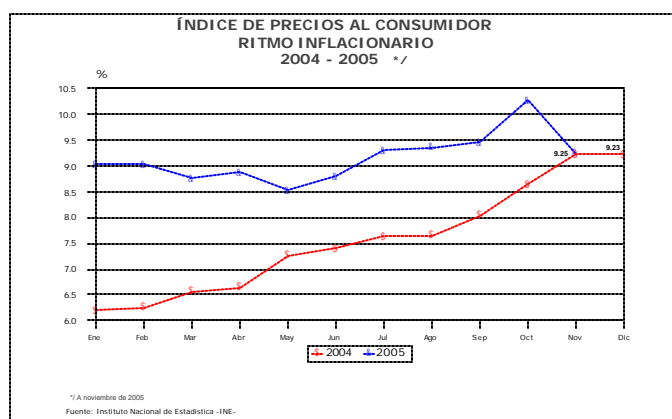
⁷ The Trust Index of the Economic Activity of the Private Analysts Panel has the purpose of measuring the perception of the economic analysts, on the current economic situation and in the business environment, as well as on the economic evolution of the country in the near future. It is worth indicating that the expectations of the panel of national and international economic experts are picked up through the Inflation Expectations Survey -EEI- (for its acronym in Spanish) that since December 2003, the *Banco de Guatemala* does on a monthly basis and whose results are published on its Internet website.



Graph No. 16
Expectations of the Private Sector regarding the Annual Growth of the
Gross Internal Product



Graph No.17
Consumer Price Index
Inflationary Rhythm



November 2004). It is worth noting that said provision has been increasing in the last three months⁸.

II. EVOLUTION OF THE VARIABLES OF THE MONETARY POLICY

A. INFLATION GOALS

1. Consumer Price Index -CPI-

According to the CPI, made up by the National Statistic Institute –INE (for its acronym in Spanish) - to November 30, 2005, in the republic, registered an inflationary rhythm of 9.25%, percentage that results higher by 0.03 percentage points, to the observed in November 2004 (9.22%), and that it is also above the goal for the end of the year established by the Monetary, Exchange Rate and Credit Policy for 2005 (between 4.0% and 6.0%).

As is analyzed up ahead, the greater part of the excess of inflation over the referred goal is explained by the effects derived of the rise in the international prices of fuel.

Special mention is deserved in the behavior of the prices in October, when the inflation was affected by tropical storm Stan, registering the highest inter-monthly variation since November 1998 (date on which the country was affected by Hurricane Mitch). Said behavior is mainly explained by the lack of supplies of agricultural products and of the damage of the communications infrastructure; however, when the supply of agricultural products normalized and when a decrease in the price of fuel was registered in November; the prices normalized, which coincides in a minimum variation in the CPI being registered.

The behavior observed in the inter-annual inflation to November 2005 mainly reflects the increase that within the CPI registered the expense division of Food, non-alcoholic beverages and take out food (weighting 38.75%), with an inter-annual variation of 13.17%, that explains the 60.09% of the inter-annual variation of

⁸ It is important to highlight that the EEI of October was made after the passing of tropical storm Stan.



CPI. Due to their increase in participation, the following index groups of expense, highlight: *Vegetables, legumes, and tubercles* (23.98%); *Bread and cereals* (21.03%); *Meats* (8.52%); and, *Take out foods and junk food* (7.75%), that together explain the 84.91% of the inter-annual variation of said expense division. On the other hand, the basic expenses that registered the greatest rises in the inter-annual level are *the tortilla products* (38.99%), *bread* (17.75%), that together represent the 24.01% of total inflation to November 2005.

The division of Transportation and Communications expenses (weighting 10.92%) registered an inter-annual variation of 11.02% and explains the 11.71% inflationary rhythm to November. The following coincided in said behavior; the mean prices are *Gasoline* (31.46%); *suburban transportation* (25.60%); *aerial transportation* (22.82%); and *urban transportation* (5.64%).

The division of expense *Living, water, electricity, gas and other fuels* (weighting 10.00%), registered an inter-annual variation of 6.36% and explains the 6.45% of the total inflationary rhythm. Highlighted in this division are the rises in mean price of *propane gas* (20.15%) and *the real rent of housing* (5.68%).

On the other hand, the division of expense of *Furniture, housing equipment and routine house maintenance* (weighting 7.95%) registered an inter-annual variation of 5.70% and explains the 4.61% of total inflationary rhythm, highlighting the rises in the *Housing maintenance* (6.39%).

The behavior of the four divisions of expense mentioned explains the 82.86% of inflationary rhythm observed to November 2005.



Monetary, Exchange and Credit Policy:
Evaluation to November 2005 and Proposal 2006



CONSUMER PRICE INDEX
INFLACIONARY RHYTHM

(Base: December 2000 = 100.0)

November de 2005

EXPENSE DIVISION	EXPENSE WEIGHTING	November 2004	November 2005	INFLATIONARY RHYTHM /1	PARTICIPATION IN THE INFLACIONARY RHYTHM /2	PARTICIPATION IN THE INFLATIONARY RHYTHM AS A PERCENTAGE /3
GENERAL INDEX	100.00	133.11	145.42	9.25	9.25	100.00
1. Food, non-alcoholic beverages and take out foods	38.75	144.95	164.04	13.17	5.56	60.09
2. Clothing and shoes	7.94	120.83	124.68	3.19	0.23	2.49
3. Housing, water, electricity, gas and others	10.00	124.77	132.71	6.36	0.60	6.45
4. Mobile, housing and other routine maintenance	7.95	125.31	132.45	5.70	0.43	4.61
5. Health	5.48	127.33	134.90	5.95	0.31	3.37
6. Transport and communication	10.92	119.75	132.95	11.02	1.08	11.71
7. Recreation and culture	6.83	130.33	137.12	5.21	0.35	3.77
8. Education	5.60	134.94	143.94	6.67	0.38	4.10
9. Goods and Diverse services	6.53	128.59	135.00	4.98	0.31	3.40

Source: National Statistics Institute - INE-

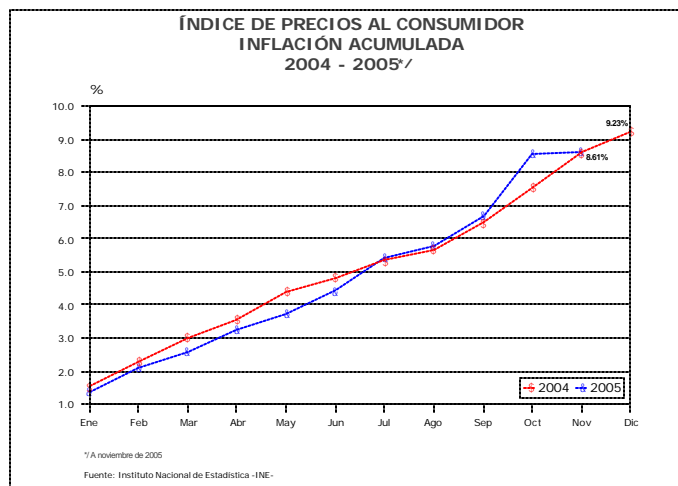
1/ Variation rate of the month in an exam regarding the same month the previous year.

2/ Incidence in the variation.

3/ Participation in the variation: (Incidence / Variation total) * 100.

As to the accumulated inflation to November of the present year, in the republic, it reached a variation of 8.61%, similar to the registered the same month the previous year (8.59%).

Graph No.18
Consumer Price Index
Accumulated Inflation



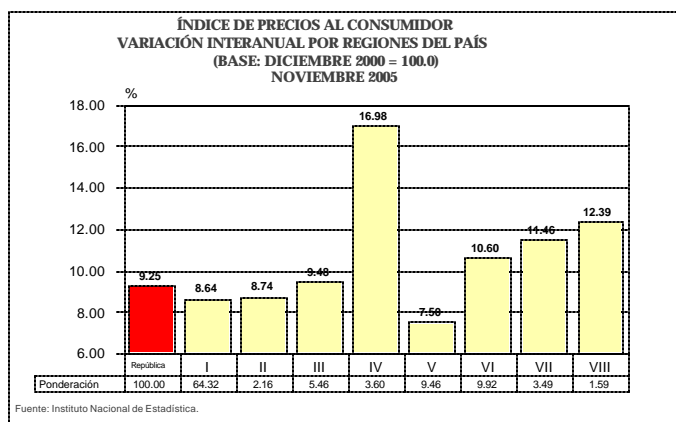
At the regional level⁹, region IV (South-east) registered the highest inflationary rhythm, 16.98%; region VIII (Petén) registered an inter-annual variation of 12.39%; and, region VII (North-west) registered a variation of 11.46%. On the other hand, region I (Metropolitan), that has a weighting of 64.32% in the total CPI, observed an inflationary rhythm of 8.64%, lower by 0.61 percentage points to the national weighted average (9.25%).

In region IV (South-east), with a weighting of 3.60% within the structure of the regions, important rises were registered in the mean price of the *tortilla products* (123.49%); *other vegetables and produce* (131.57%); *bread* (20.98%); and, *home water service* (370.59%). It is worth indicating that the mentioned increases, as a whole, represent 60.36% of the inter-annual variation of said region.

In region VIII (Petén), with a weighting of 1.59% within the total of regions, the inter-annual variation registered is mainly explained, by the increase in the mean price of *bread* (64.62%); *tortilla products*

⁹ Region I, Metropolitan (Guatemala); Region II, North (Alta Verapaz and Baja Verapaz); Region III, North-east (El Progreso, Zacapa, Izabal and Chiquimula); Region IV, South-east (Santa Rosa, Jalapa and Jutiapa); Region V, Central (Chimaltenango, Sacatepéquez and Escuintla); Region VI, South-west (San Marcos, Quetzaltenango, Totonicapán, Retalhuleu, Suchitepéquez and Sololá); Region VII, North-west (Huehuetenango and Quiché); and, Region VIII, Petén.

Graph No.19
Consumer Price Index
Inter-annual variation per Region in the country
(December Base 2000=100.0)
November 2005



(55.27%); *beans* (47.25%); *other vegetables and produce* (74.58%); *and, gasoline* (38.78%), products that, together, explain the 53.10% of the variation of the region.

The increase observed in the region VII (North-west), with a weighting of 3.49%, basically obeys the rise registered in the mean *price* of bread (17.22%); *tortilla products* (36.74%), *potato* (45.20%) and in the mean price of *other fresh fruit* (45.20%), products that together represent 25.47% of the variation of said region.

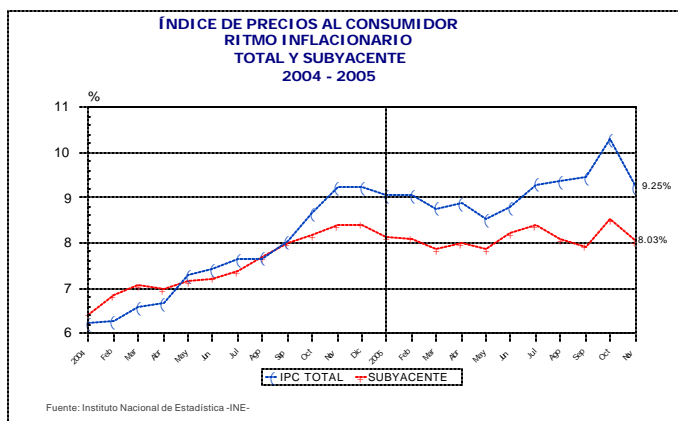
2. Subjacent Inflation

The subjacent inflation is the growth rate of a price index that, with the purpose of eliminating distortions in the calculation, excludes some of the goods and services whose prices are highly volatile or are subject to external shocks. In this regard, in Guatemala's case, the indexes of the following groups are excluded: *expense of fresh, conserved and dried fruit; produce, vegetables and tubercles; manufactured and natural gas and gas from petroleum; and gasoline*, whose weightings within the CPI are 1.28%, 3.77%, 1.09% and 2.05%, respectively, for a total of 8.19%.

In that sense, the subjacent inflation in the entire republic registered to November 2005, had an inter-annual variation of 8.03%, lower by 1.22 percentage points regarding the total inflation (9.25%), that is mainly explained because the following headings are eliminated from its composition that registered significant increases: *gasoline* (that registers a rhythm of 31.46%); *vegetables, legumes and tubercles* (23.98%); *natural and manufactured gas and gases liquefied from petroleum* (20.15%); and *fresh, dried and conserved* (9.66%).

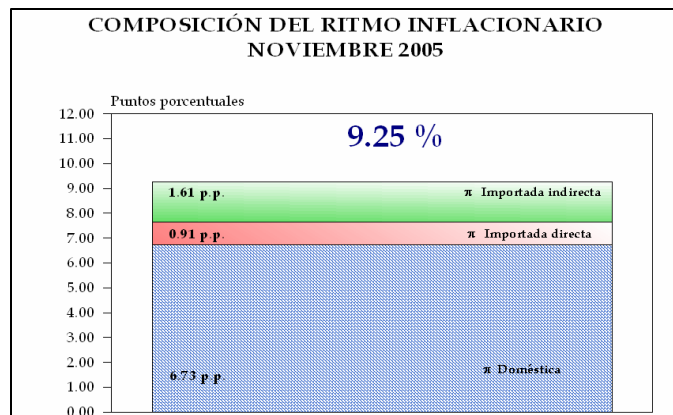
The behavior of the inflationary rhythm is determined by the evolution of prices of bread and tortilla products, which together explain 30.2% of the subjacent inflation to November 2005.

Graph No.20
Consumer Price Index
Inflationary Rhythm
Total and Subjacent



3. Imported Inflation

Graph No.21
Composition of the inflationary rhythm
November 2005



The behavior of the inflationary rhythm registered during the year was significantly influenced by the imported inflation, which, at the same time, responds mainly to the rise in the international price of oil.

For the effects of analysis, the imported inflation can be divided in direct and indirect. The direct refers to the effect that the international price of oil has on the prices of 32 goods and services of the basic food basket that in its cost structure makes intensive use of the products derived from crude oil. The calculation of the same is possible to do given that the statistic information of national accounts -SCN93-already allows counting on the cost structure of production of these goods and services. On the other hand, the indirect imported inflation, or second round, refers to the increase in the prices of those goods and services that in its costs structure does not incorporate those derived from oil, but are affected indirectly by aspects such as the increase in the prices of transportation, electricity and others¹⁰.

CALCULATION METHODOLOGY OF DIRECT IMPORTED INFLATION

In order to make the calculation of direct imported inflation use the structure of intermediate consumption of the base year 2001 of the Fourth Revision of National Accounts System -SCN 93-, for which the percentages of the consumer goods derived from oil are established, representing within the costs of production 32 goods and services.

Following, the calculation is begun considering the cost of the referred goods and services that are not affected by the petroleum derivatives, in the following manner:

$$VINDP = V_o \left(\frac{INDP}{100} \right)$$

VINDP = Variation of index of each good or service, excluding the consumer goods derived from oil

V_o = Variation of the index (original)

INDP = % of consumption goods not derived from petroleum

The new index is obtained for the 32 basic expenses.

$$I_a = I_{a-1} \left[1 + \left(\frac{VINDP}{100} \right) \right]$$

VINDP = Variation of the index of each good or service, excluding the consumer goods derived from oil

I_a = Current adjusted index

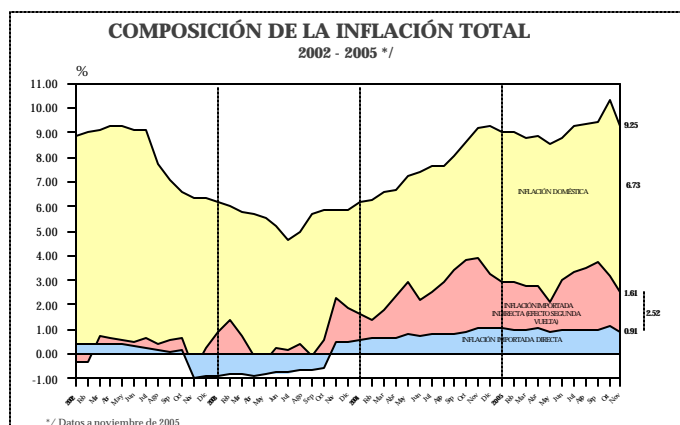
I_{a-1} = Previous adjusted index

¹⁰ The calculation of the indirect imported inflation is made according to the methodology contained in the Joint Memorandum 1-2004, dated October 22, 2004, regarding the bond between the monetary policy and the imported inflation, which is found on the website of the *Banco de Guatemala* www.banguat.gob.gt/publica/doctos/bgdocto031.pdf.

Later, a new index of prices is formed, which is derived of the consolidation of the new indexes of 32 goods or services (that no longer includes the effect of the variation of prices of oil derivatives) with the indexes of 186 goods and services remaining that conform the CPI.

Last, the new index obtained is the one used to calculate the inflationary rhythm, which is subtracted from the inflationary rhythm of the CPI total, obtaining in that way the direct imported inflation.

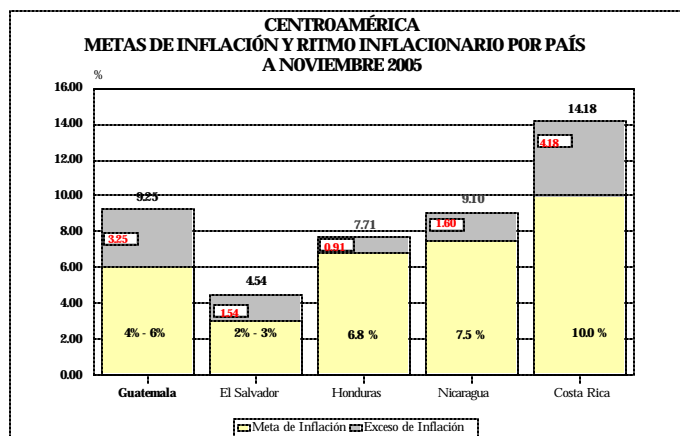
Graph No.22
Composition of the Total Inflation



To November 2005, the imported inflation explains 2.52 percentage points of the inflationary rhythm (9.25%), of which 0.91 percentage points correspond to the direct imported inflation and 1.61 percentage points to indirect imported inflation.

It is worth indicating that the imported inflation is also observed in other countries in Central America, in which, as a result, the inflationary rhythm is situated over the foreseen goal.

Graph No.23
Central America
Inflation and Inflationary Rhythm goals per country to November 2005



4. Econometric Prognosis of inflation for December 2005

Method 1:

a. Aspects of methodology

According to the methodology used by the Department of Economic Statistics of the *Banco de Guatemala*, the projection of the CPI is made in three stages. In the first stage, eight of the nine divisions that make up the CPI are foreseen uni-variated, using the sustained multiplication exponential method of Holt Winters, which is appropriate for series that contain a lineal tendency and multiplication seasonal factors,



which is the case of each component of the CPI. Said methodology is represented in the following manner:

$$\hat{y}_{t+k}^n = (a + bk)c_{t+k}$$

Where:

\hat{y}_t^n = Component n of the CPI in the period t;

where n: 1,2,...8

k = Periods of prognosis

a = Permanent component (intercept)

b = Tendency

c = seasonal multiplication factor

In the second stage, the prognosis for the remaining division, Transportation and Communication, is foreseen. For making the prognosis, normal coefficients of variation are applied, average between 2003 and 2004 corresponding to the international oil prices; and later, to said coefficients are added the proportional part of the variation of the future oil prices, using, for the effect, the percentage of weight that has the gasoline of the CPI (2.05%).

Finally, in the third stage the prognosis are integrated in the nine headings that make up the CPI, through the application of the weight of each heading has said index, such as is indicated in the following:

$$y_t = \sum_{n=1}^9 y_t^n w^n$$

Where:

y_t : Prognosis of the CPI in the period t

w^n : weighting of the division of expense

b. Analysis to November 2005

For December 2005, according to the estimations made, the CPI would reach an inter-annual variation of 9.22%, mainly influenced by the international prices of oil whose position to future are still quoted to prices close to US\$60.00 per barrel.

In that sense, this econometric projection suggests that the imported second round inflation is the main risk factor that explains the behavior of the CPI for 2005. In effect, the CPI would be mainly determined by the behavior that is expected in the division of Food, non-alcoholic beverages, and take out food, which



would be higher to that of 2004, result of the evolution of the prices of bread and of tortillas, that during the present year have experimented significant rises derived of the increase in the costs of transportation, electricity and propane gas; and by the growth projected in the division of Housing, water, electricity, gas and other fuels, due to the behavior of the price of propane gas.

Method 2:

a. Methodological Aspects

According to the methodology used by the Department of Economic Investigations of the *Banco de Guatemala*, the prognosis of the CPI is made in two stages. In the first, it is estimated that a simple regression between the CPI and the prices expected for oil in the futures market of New York. Of said regression the estimation errors are obtained (ϵ_t). In the second stage a multiple regression model is estimated, in which the CPI is function of the prices expected from oil in the futures market of New York, of the first delay of the CPI and of the seventh delay in the errors obtained in the simple regression in the first stage. The specification of the regression to estimate is the following:

$$IPC_t = b_0 + b_1 PF_t + b_2 IPC_{t-1} + b_3 \epsilon_{t-7} + m_t$$

Where:

IPC_t = General Consumer Price Index in the t period

PF_t = Future prices of oil observed in the t period

ϵ_t = Error of estimation obtained in the simple regression between CPI and PFt in the t period

m_t = Error of estimation

According to the prognosis of inflation obtained through this method, the CPI would reach an inter-annual variation of 9.15% for December 2005.

It is worth indicating that said projection suggests that the impact of the oil price in the inflation is statistically significant. In effect, the main variable that is used to generate the prognosis for this method is that of the future prices of oil, which vary constantly depending on the expectations in the futures markets



on the possible events that affect the crude global markets. Therefore, the prognosis obtained through this methodology is very sensitive to variations in the prices expected by said product.

B. INTEREST RATES

1. Of Operations of monetary stabilization -OEMs- (for its acronym in Spanish)

a. In national currency

During the understood period from January to November 2005, the interest rate of certificates of term deposits -LTDs- for 7 days (leading rate of the monetary policy)¹¹, that is negotiated in the Electronic Banking Money Table -MEBD-(for its acronym in Spanish) and in the stock exchange registered a nominal raise of 45 basic points in the first semester, when going from 2.55% to 3.00%¹². During the second semester, the referred interest rate registered a nominal raise of 100 basic points, therefore, at the end of November was located at 4.00%¹³. The referred raises were adopted by the Execution Committee of the *Banco de Guatemala*, with the purpose of destroying the inflationary expectations.

As to the interest rate of such operations the 28 day terms, the same was kept at 3.24% during January and February. As of February 28, 2005 the Execution Committee agreed to translate said option of fundraising to the bidding mechanism, according to the participation principle in the money market contained in the monetary policy for 2005, as to converging toward the use of an only leading interest rate for the operations of monetary stability in the short term.

On the other hand, the interest rate of the monetary stabilization operations in the bidding operations were determined by the market conditions due to the fact that the Execution Committee agreed that as of January 4, 2005 of the *Banco de Guatemala* will modify its participation in said mechanism, for

¹¹ The Execution Committee of the *Banco de Guatemala*, in its session of January 21, after knowing the result of the corresponding technical studies, established that as of January 24 the corresponding interest rate to the 7 day term would be the leading interest rate of the monetary policy, since this one is the most influential on the behavior of the inflation.

¹² The first adjustment was of 20 basic points and was applied as of February 21, when the interest rate of the referred term went from 2.55% to 2.75%; whereas the second adjustment of 25 basic points was applied as of May 23, increasing the said interest rate to 3.00%.

¹³ All adjustments were of 25 basic points each one and were applied as of July 25, August 22, September 19, and of November 21.



which, with the objective of eliminating the practice of fixing the interest rates for the greater than 28 day terms¹⁴, determined the creation of maximum limits (quotas) for each of the said terms, which were fixed fundamentally in function of the monetary spaces determined according to the monetization flow. The biddings were made daily until January 28 and as of the 31 of that month, the Execution Committee agreed that the *Banco de Guatemala* would convene the biddings three times per week (Monday, Wednesday and Friday), measure taken in consistency with the objective of gradually reducing the frequency of the biddings, at the same time watching over the markets that they were duly and previously informed of said changes.

With the purpose of adequate fund raising of liquidity to the estimated flow of monetization and privilege the gradual neutralization of liquidity in greater terms, the Execution Committee agreed that as of May 3 the bid would be convened only to the 364 and 728 day terms, strategy kept during May and June.

For the second term, the Execution Committee taking into account the agreed in matter of coordination with the fiscal policy for the participation in the money market, agreed that, as of July 4, the *Banco de Guatemala* would convene the terms of 91 days and 364 days; Wednesdays for 182 and 728 day terms, with pre-announced quotas for each of the terms; and Friday for 1456 day terms (4 years), 2184 days (6 years) and 2192 days (8 years), with the difference that for these terms there was no pre-established quota for fund raising with the objective of favoring greater fund raising for long terms. For the corresponding awarding, the Committee decided that it would determine the amount to award for each term, so much so that for the determination of the interest rate to apply, would take the corresponding to each of the terms in a yield curve calculated through the interpolation of the interest rates to 1 and 10 year terms as a reference. As of September 26 a pre-announced quota was established for the 2912 day term (8 years), given that the Execution Committee considered that the observed competition in the bids of

¹⁴ As of February 28, 2005 the fund raising option for the 28 day term was transferred to the bid mechanism. In the months of March and April, for said term the weighted average rates of 3.18% and 3.24% were registered, similar to the observed in January and February (3.24%), when said operations were made in bid mechanism on the MEBD and in the stock exchange.



the LTDs for 8 years were very limited and that a restricted bid quota for said term would propitiate a greater competition between the participants and limit the financial costs associated. The payment of interest for the terms greater than 364 days would be every semester, with the end of maintaining the same conditions in which the *Ministerio de Finanzas Públicas* (Equivalent to the Department of the Treasury) is operated.

In the following table, it can be generally observed that the average weighted monthly interest rate in different terms has showed variations, manifesting that in February the interest rates were higher for the majority of the terms.

Monthly weighted average interest rate of operations of monetary stabilization for bidding from January to November 2005. (In percentages)

TASAS DE INTERÉS PROMEDIO PONDERADO MENSUAL
DE OPERACIONES DE ESTABILIZACIÓN MONETARIA
LICITACIÓN
DE ENERO A NOVIEMBRE 2005
- En Porcentajes -

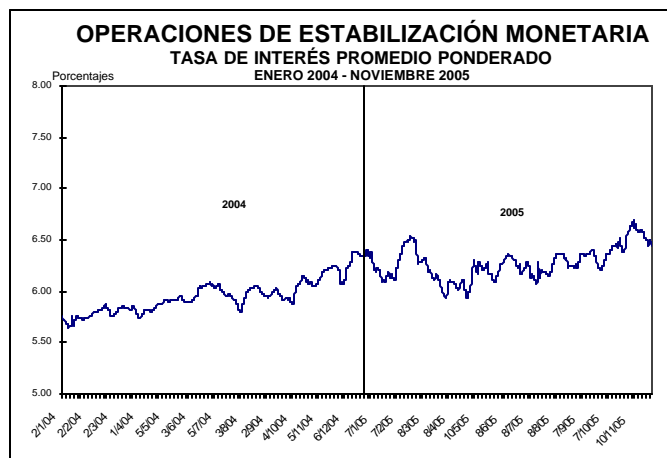
PLAZO EN DÍAS	ENERO	FEBRERO	MARZO	ABRIL	MAYO	JUNIO	JULIO	AGOSTO	SEPTIEMBRE	OCTUBRE	NOVIEMBRE
28 ^{a/}	-	-	3.18	3.24	-	-	-	-	-	-	-
91	5.77	5.99	5.53	4.94	-	-	3.50	5.00	4.98	4.97	5.00
182	5.84	6.11	5.94	5.52	-	-	5.49	5.48	5.61	5.43	5.50
364	6.13	6.50	6.48	6.30	6.12	6.26	6.11	5.99	6.28	6.13	6.25
728	6.83	7.06	7.04	7.01	7.00	7.05	6.90	6.95	6.95	6.90	7.00
1092 ^{b/}	7.85	7.95	7.96	-	-	-	-	-	-	-	-
1456	7.97	-	8.02	-	-	-	6.98	7.23	7.25	7.25	7.25
2184	-	-	-	-	-	-	7.60	7.68	7.75	7.75	7.75
2912	-	-	-	-	-	-	8.21	8.26	8.39	8.40	8.40

a/ Este plazo dejó de convocarse a licitación a partir del 3 de mayo de 2005.

b/ Este plazo dejó de convocarse a licitación a partir del 21 de marzo de 2005.

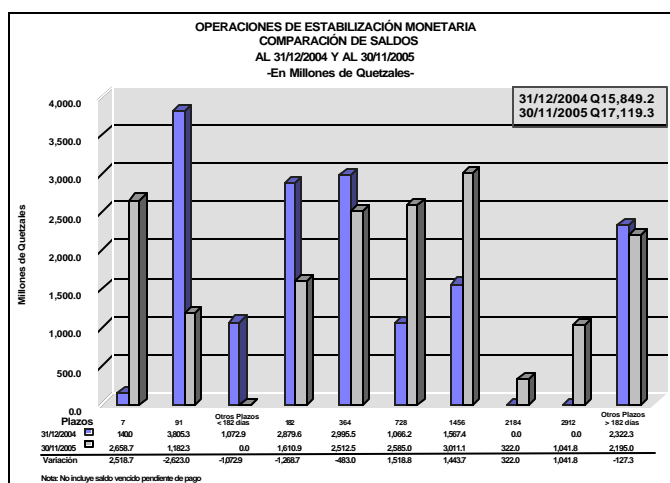


Graph No.24
Monetary Stabilization of Operations
Weighted average interest rate
January 2004 to November 2006



Regarding the weighted average interest rate of the total balance of the monetary stabilization operations, during the period from January to November 2005, showed stable behavior with a slight tendency to the rise, when going from 6.32% to 6.45%, due to the recognized interest rates in the fund-raising for long terms (4, 6 and 8 years) and the change in the structure of the balance of OEMs for terms, to the observed in a transfer of the liquidity of lesser terms of 180 days toward greater terms¹⁵. In the following graphs the behavior of the interest rate in January 2004 to November 2005 is shown and the balances are compared to the operations of monetary stabilization from December 31, 2004 with those of November 20, 2005.

Graph No.25
Monetary Stabilization Operations
Operation of Balances



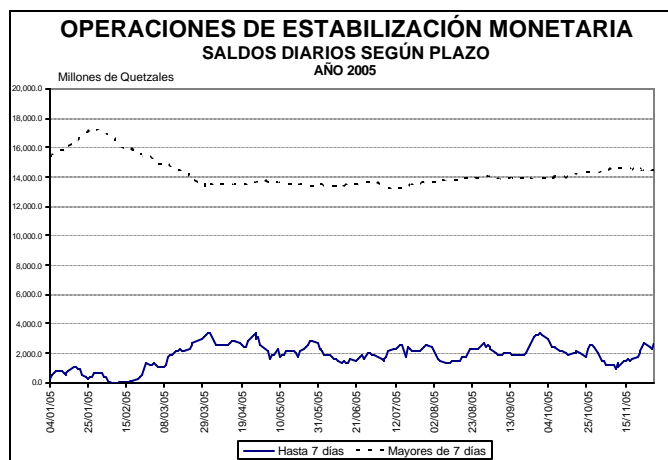
When analyzing the operations of monetary stabilization for fund-raising terms, these can be divided in operations of 7 days (associated to the leading interest rate of the monetary policy) and in greater terms. As can be observed in the following graph, during the analyzed period said operations have concentrated greatly in terms greater to 7 days, reaching a maximum of Q17,279.4 million (96.1% of the total), on February 1, 2005 and a minimum of Q13,206.4 million (80.2% of the total) on March 30, 2005. The total balance of the monetary stabilization operations registered to November 30, 2005 ascends to Q17, 119.3 million¹⁶, of which Q2, 658.7 million (15.5%) correspond to a 7 day term.

¹⁵ To December 31, 2004 the monetary stabilization operations in terms less than 180 days represented 31.7% of the total and in terms greater than 180 days represented 68.3% of the total; whereas, on November 30, 2005, said operations in shorter terms to 180 days represented 22.4% and in terms greater than 180 days represented 77.6%.

¹⁶ Includes expired balances pending the payment of Q4.1 million.



Graph No.26
Monetary Stabilization Operations
Daily Balances according to term



On the other hand, as to the operations of giving liquidity, the Execution Committee agreed to keep during the first three weeks of January offer bids of liquidity in 7 day terms, at an initial interest rate of 11.15%. Later, on January 21, 2005 said Committee agreed to decrease the referred interest rate to 7.65%, with the objective of reducing the breach between the leading active interest rate (of liquidity) and the liable (of placement). It is worth mentioning that the observed increases in the leading liable interest rate of the monetary policy that to November 20 was at 4.00%, having cooperated in the reduction of said breach. The object of having begun the process of reduction of the referred breach is that of propitiating the conditions so that the short term interest rate does not manifest excessive volatility, since it would not be convenient because, in the first place, would cause distortions in the process of financial intermediation and, in second place would interfere with the appropriate transmission of the monetary policy through the banking system.

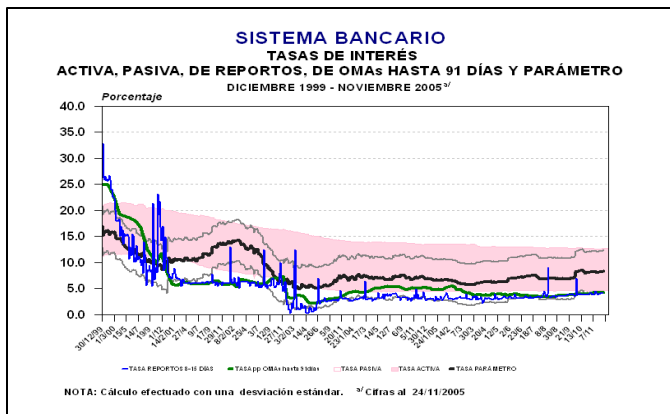
b) In foreign currency

During 2005 the *Banco de Guatemala* continued convening a bidding of deposits to term expressed in US dollars, with the purpose of cooperating with the reduction of the volatility observed in the exchange rate. The biddings were made, as of January 10, on Tuesday and Thursday of each week. Later, as of September 12, a bid was convened only on Tuesdays of each week, considering, on the one hand, that in the market a greater demand had not been manifested and, on the other hand, that said measure would be consistent with the reduction of the frequency of the biddings expressed in quetzales.

In the described context, until November 30, 2005 the total fund-raising of these operations was at US\$30.9 million, having placed the greater amount (US\$29.6 million) in a term of 91 days, an interest rate between 2.85% and 2.89% and US\$1.3 million for a term of 336 days, at interest rates between 3.40% and 3.89%. The balance at the end of each indicated month was US\$1.3 million.

Graph No.27
Banking System
Interest Rate

Asset, Liabe, Repurchase agreements, OMAs to 91 days and Parameter
December 1999 – November 2005



2. Parameter Rate

The parameter rate is an indicator based on the “Taylor Rule”¹⁷, that incorporates adjustments on the base rate (or neutral) functioning on the inflation differentials, of aggregate demand and of the nominal exchange rate, so that the interest rate resulting indicates the levels of interest rate that should be forbidden in the market to be compatible with the existing inflation level. The Monetary, Exchange rate and Credit Policy for 2005 establishes that the parameter rate would compare with the weighted average interest rate of operations of repurchase agreements between 8 and 15 days, as with the relevant interest rate of monetary stabilization operations.

To November 24, 2005, the parameter rate was at 8.37% and its upper and lower limits, calculated with a standard deviation, were situated at 12.32% and 4.42%, respectively. It is worth indicating that until September 2005 the repurchase agreement rate for the 8 to 15 day term was held slightly higher than the lower limit of the band of the parameter rate; however, as of October the same began slightly below said limit until on November 24, it was at 4.15%. On the other hand, equally, also from October to November, the weighted average interest rate up to a 91 day term of term deposit certificates –LTDs-(interest rate relevant of the monetary stabilization operations) began to locate slightly below the lower limit cited, on November 24 it was at 4.31%. It is worth pointing out that, while the parameter rate shows a slight tendency to the rise, the money market rates are made with lesser dynamism, suggesting that as of October, a relaxing has been produced of the policy regarding its “neutral” level, therefore, a space exists for a more restrictive monetary policy.

¹⁷ The Taylor Rule is an indicator that is used by many central banks to orient the participation decisions in the monetary market, in virtue of the fact that it reflects the adjustments of the interest rate by inflation and by excess of demand that result compatible with the fundamental objective of the monetary policy. In Guatemala’s case it has been considered convenient to add an adjustment by exchange movements, therefore it has been named the “Parameter Rate”.

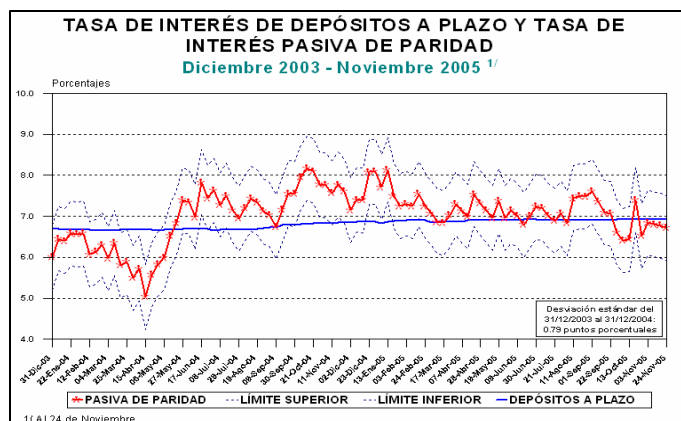


3. External Competitivity of the liable domestic interest rate

The external competitiveness of the liable domestic interest rate of the national currency must be evaluated if it is to be compared with the parity interest rate. The latter is defined as the sum of three elements: (i) a comparable international interest rate, (ii) an exchange risk premium and (iii) a risk country premium.

For measuring effects, the interest rate is used for six month term deposits in the domestic market of the United States, as an external liable interest rate comparable to the domestic liable interest rate in national currency (weighted average interest rate of the national banking system for term deposits). Also, as an approximate measure of the exchange risk premium, the difference between the average exchange rate (purchase and sale) observed and the closing exchange rate in the futures Guatemalan market are used. At the same time, to approximately measure the country risk premium, the difference between the return rate of the Guatemalan bonds placed in the financial international market (weighted average of the 1997, 2001, 2003 and 2004 issues) and the return rate of the Treasury Bonds of the United States Treasury in 10 year terms is calculated.

Graph No.28
Term Deposit Interest Rates and Parity Liable Interest Rate
December 2003 – November 2005

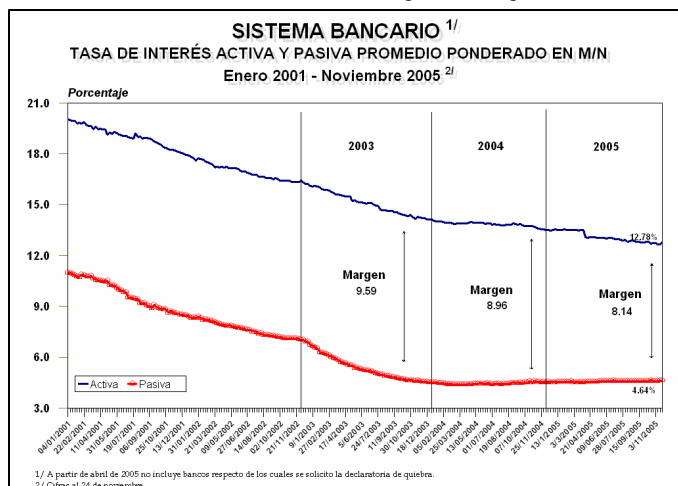


In the January-September 2005 period, was observed that the weighted average interest rate of term deposits in the banking system, in general terms, was lower than the liable parity rate. In contrast, in the October-November period, the weighted average interest rate of term deposits of the banking system was over the parity liable rate. In effect, to November 24, 2005 these reached 6.94%, and 6.71%, respectively. Without taking into account the transaction costs, this situation would indicate to the economic agents that as of the month of October, 2005 there would result more favorable internal savings, contrary to the observed during the first nine months of the current year.

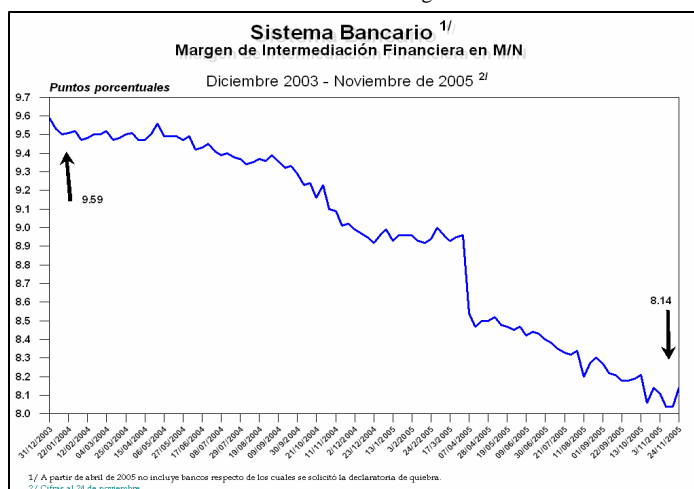
As to the orientation of the monetary policy that offers the mentioned variable, it was observed that when comparing the interest rate of the term deposits in the banking system with a tolerance margin of the



Graph No. 29
Banking System
Asset and Liabile Interest Rate Weighted Average in M/N



Gráfica No. 30
Banking System
Financial Intermediation Margin in M/N



liable parity rate¹⁸, as of the third week of January until November 24, 2005, the same was located within said margin, therefore the orientation of said variable suggested that the monetary policy be kept without any changes.

4. Weighted Average Asset and Liabile Interest Rate of the banking system

a) In national currency

From January to November 2005, the interest rates, weighted average, continued with a stable behavior, but with a slight tendency toward the low. In effect, the asset interest rate, weighted average, to November, was at 12.78% annual, lower by 0.72 percentage points to the observed at the end of December, 2004 (13.50%); while the parity rate was at 4.64%, greater by 0.10 percent regarding the registered to December 31, 2004 (4.54%). It is worth indicating that the behavior observed of the asset interest rate is because as of April 7 the numbers no longer include information of the banks which were asked to declare bankruptcy, which represents a decrease of around 0.41 percentage points, while in the liable rate the effect was null.

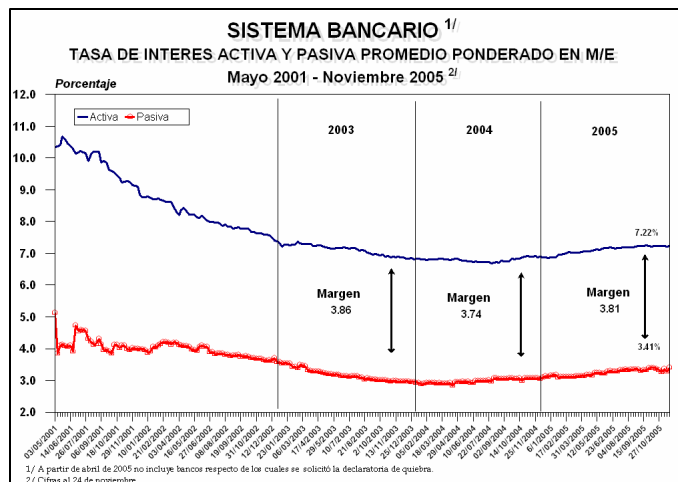
Therefore the tendency that the asset and liable weighted average interest rates registered, the financial intermediation margin, in national currency, was at 8.14 percentage points to November, 2005, lower by 0.82 percentage points to the observed at the end of December, 2004. In the same manner, in this result the exclusion of the bankrupt banks influenced.

¹⁸ The Monetary Board in resolution JM-160-2004 dated December 29, 2004, agreed that the parity liable rate would be included in a tolerance margin of +/- a standard deviation. When considering a weekly series with information from between December 31, 2003 to December 24, 2004, it was established that a deviation standard is equivalent to 0.79 percentage points.



Graph No. 31
Banking System
Asset and Liabilities Interest Rate Weighted Average in M/N

b) In foreign currency

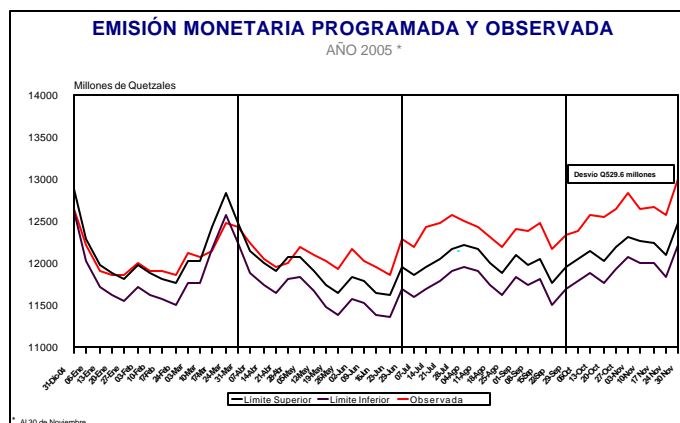


The asset and liability interest rate, weighted average, in foreign currency, to November 2005 has showed a stable behavior, with a slight tendency to rise. In effect the asset interest rate to November 24, 2005 was at 7.22%, higher by 0.37 percentage points to the observed on December 31, 2004: while the liability rate showed an increase of 0.30 percentage points, when located at 3.41% on November 24, 2005.

As a result of this behavior of the liability and asset interest rate, the financial intermediation margin, in foreign currency increased by 0.07 percentage points, when going from 3.74 percentage points in December 2004 to 3.81 percentage points on November 24, 2005.

**C. MONETARY ISSUE AND ACCOUNTS
BALANCE OF THE BANCO DE
GUATEMALA**

Graph No.32
Programmed and Observed Monetary Issue



1. Monetary Issue

According to the monetary program reviewed for 2005, it was estimated that at the end of the year the monetary issue demand would grow around 8.0% regarding the observed level at the end of 2004, compatible with an expected growth rate of the economic activity of 3.2% and with an inflation goal of between 4% y 6%.

The behavior of the monetary issue to November 2005 can be observed in the graph.

Until January 20, 2005 the trajectory of the monetary issue was kept within the programmed corridor, due to the demonetizing effect that until this date generated the increase of the operations of monetary stabilization with the private sector for Q1, 645.0 million.

As of the last week of January until March 10, the monetary issue was scarcely above the upper limit of the referred corridor, registering an average deviation of Q54.4 million. The excess of issue observed from

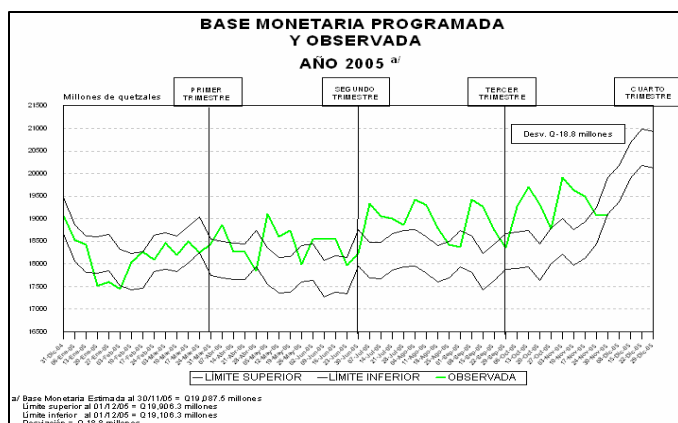


the end of January is explained, on the offer part, fundamentally, by the greatest monetization of external origin- that in net terms was Q652.0 million (US\$81.5 million)- mainly originated from the purchase of foreign currency of the *Banco de Guatemala* in the exchange market¹⁹, which was well compensated in good measure by the demonetizing effect of the increase of the position of the rest of the public sector for Q785.4 millions, that includes, a greater level of deposits of the Central Government in the *Banco de Guatemala* for Q584.1 million. On the other hand, the behavior of the operation of monetary stabilization with the private sector in said period was monetizing, when decreasing the balance of said operations in Q1, 024.7 million.

In the period between March 17 and 31, the monetary issue was below the inferior limit of the programmed corridor, to end the trimester within the referred corridor. Said situation is explained by the demonetizing effect derived by the increase in the deposits level of the Central Government in the *Banco de Guatemala* for around Q493.0 million.

During the month of April the monetary issue, in general, was located around the upper limit of the programmed corridor, registering an average deviation of Q71.8 million, associated, on the one hand, to the decrease in the total balance of the monetary stabilization operations for approximately Q568.0 million and, on the other hand, to the monetization of external origin for Q568.8 million (around US\$71.0 million), mainly derived from the purchase of foreign currency on behalf of the *Banco de Guatemala* in the exchange market for US\$65.0 million.

Graph No. 33
Programmed and Observed Monetary Base



As of the first week of May, until November 30, the behavior of the monetary issue was over the upper limit of the programmed corridor, registering an average deviation in said period of Q357.9 million whose maximum point was observed on October 20, date in which it reached a deviation of Q524.7 million. The excess of the monetary issue observed in the mentioned period is explained, on the offer side, basically because of the monetization of internal origin derived of the decrease in balance of the monetary stabilization operations with the private sector in

¹⁹ The *Banco de Guatemala*, according to the current Monetary, Exchange Rate and Credit Policy, began to participate in the exchange market on February 22, purchasing US\$106.4 million from said date until March 10.



national and foreign currency for Q616.1 million, and for the monetization of external origin for Q230.4 million (US\$28.8 million), associated to the purchase of foreign currency of the *Banco de Guatemala* in the exchange market. The monetizing factors mentioned were partially and basically compensated until November 30 because of the increase in investments in LTDs of the rest of the entities of the Public Sector for Q663.9 million, and because of the increase in the total position of the banks of the system with the *Banco de Guatemala*, for Q364.5 million.

It is worth indicating that, in relative terms, the average deviation of the monetary issue during the year was around 1.9% regarding the average balance of the monetary issue, which could be considered moderate. It is worth pointing out that the recent econometric studies indicate that the sensibility of the Consumer Price Index –CPI- before the increase in the deviation of the monetary issue, is not very significant, since a 1% increase in the referred deviation increases the CPI by 0.00345% with a 12 month delay.

On the other hand, it is worth indicating, that if the behavior of the primary liquidity is analyzed in the context of a more ample monetary aggregate, as is the monetary base, during 2005 it was, on average, around the upper limit of the programmed corridor for the monetary base, associated to the stability in the banking retention coefficient, which puts into perspective that the money of high power was not the main source of the inflationary pressures during the year.

2. Analysis of the balance accounts of the *Banco de Guatemala*

The Monetary, Exchange Rate and Credit Policy for 2005, contemplated, among other aspects, the trimester monetary program, which contains the estimated behavior of the main accounts of the balance of the central bank, where it was estimated that the demand of the monetary issue would grow around 8.0% regarding the observed level at the end of 2004; however, derived from the fact that some events were observed that were not contemplated in the original monetary program (approved by the Monetary Board in



December 2004), which came about in the monetary offer, therefore it was necessary to revise them.

The revision of the monetary program was heard by the Monetary Board in its session dated June 8 and derived some adjustments, on the one hand, of the inclusion of the monetizing effect of the purchases of foreign currency made by the *Banco de Guatemala* in the exchange market, with the purpose of moderating the exchange volatility observed in the second trimester of the year and, on the other hand, of a revision on behalf of the *Ministerio de Finanzas Públicas* (Equivalent to the Department of the Treasury) of the amount of disbursements of the foreign debt.

The following is a presentation of the monetary program with numbers observed to September 30.

MONETARY PROGRAM OF THE *BANCO DE GUATEMALA* ^{a/}2005
FLOWS FROM DECEMBER 31, 2004 TO SEPTEMBER 30, 2005
- Millions de quetzales -

CONCEPT	ACCUMULATED		
	PROGRAMMED	OBSERVED	DEVIATION
I. NET INTERNATIONAL RESERVES	2149	2296	147
US\$	269	288	19
II. NET INTERNAL ASSETS	341	-2429	-2770
1. Position with the consolidated public sector	-601	-2349	-1748
1.1. Central Government	-217	-1482	-1265
1.2. Rest of the public sector	-385	-867	-482
2. Position with banks and financial institutions	-361	98	459
2.1. Credit to banks and financial institutions	-2	-3	-1
2.2. Remunerated and non-remunerated float	-359	101	460
3. Other net assets	807	168	-640
3.1. Expense and products	676	402	-274
3.2. Net Assets not classified	132	-233	-365
4. Monetary stabilization Operations	496	-347	-843
III. EXCESS (-) OR LACKING (+) LIQUIDITY	-3692	-1069	2623
IV. DEMAND OF MONETARY ISSUE	-1202	-1202	0

a/ IT refers to the monetary program revised to May 31, 2005, which was heard by the Monetary Board for its follow up, to June 8, 2005.

Memo:			
OEMs totals	-3196	-1213	1983

The behavior of each one of the factors that intervened in the generation of monetary issue is commented in the following.



a) External monetization

The monetary program foreseen to September 30, 2005 the level of Net International Reserves (NIR) will increase in Q2, 149.0 million (US\$269.0 million); however, when ending the referred month the NIR exhibited an increase of Q2, 296.0 million (US\$288.0 million) regarding the level observed at the end of the previous year, amount higher by Q147.0 million (US\$19.0 million) to the programmed. The referred deviation mainly obeys the purchase of foreign currency of the *Banco de Guatemala* in the exchange market.

b) Position with the public sector

From January to September of the current year the central government increased its deposits in the *Banco de Guatemala* in Q1, 482.0 million, amount higher by about Q1, 265.0 million to the programmed for said period.

The increase in the government deposits in the *Banco de Guatemala* is explained, on the one hand, by the internal financing obtained during the first semester, by the placement of the treasury bonds by Q4,316.0 million, of which Q2,483.7 million were made by means of the bidding mechanism, Q1,176.9 million by means of the auction mechanism and Q655.4 million by means of the direct negotiation mechanism and, on the other hand, the least execution of public expense regarding the programmed during the period of January to September of 2005.

On their part, the rest of the public sector observed a demonetization of Q867.0 million, higher by around Q482.0 million, regarding the programmed for September 30. This result is explained by the increase registered in its investments in LTDs for Q867.0 million.



c) Position with banks and financial institutions

According to the monetary program, to September 30 the banks of the system would register a demonetizing flow of Q361.0 million, derived of the amount foreseen of the balance of banking float in the central bank on behalf of the entities. It is worth indicating that the observed behavior of the banking float until the third trimester was monetized by Q98.0 million, which represented a deviation by Q459.0 million regarding the programmed.

d) Operative result of expense and products

The net result of expense and products of the *Banco de Guatemala*, when ending the third trimester, was monetized by Q402.0 million, amount lower by Q274.0 million regarding the programmed. It is worth indicating that said difference is mainly explained, by the lowest payment of interest by LTDs, result, on the one hand, of the transfer of the maturity of the monetary stabilization operations in the short to long term, and on the other hand, of the slightest of said operations occurring, regarding the programmed.

e) Monetary stabilization operations

The monetary program had foreseen that to September 30, 2005 monetary stabilization operations for Q3, 196.0 million would have to be made in order to neutralize the excess of primary liquidity in the economy. When ending the referred month, the total balance of the OEMs (for its acronym in Spanish) would register an increase of Q1,213.0 million regarding the observed level to December 31, 2004, which generated a deviation in said variable for Q1,983.0 million.

It is worth indicating that the increase observed in the balance of monetary stabilization operations is mainly explained by the increase in the LTD investments of public entities by around Q866.4



million, as well as by the increase in the OEMs with the private sector and banks in national and foreign currency for Q346.2 million.

**MONETARY PROGRAM 2005
FLOW IN MILLIONS OF QUETZALES**

CONCEPT	TRIMESTER 2005				Total 2005
	I	II	III	IV	
I. NET INTERNATIONAL RESERVES	1084	596	616	-296	2000
US\$	136	75	77	-37	250
II. NET INTERNAL ASSETS	-1659	-951	-887	2464	-1033
1. Position with the consolidated public sector	-966	-2557	1173	3113	763
1.1. Central Government	-721	-2184	1423	3122	1639
1.2. Rest of the public sector	-245	-372	-250	-9	-876
2. Position with banks and financial institutions.	417	70	-388	-819	-720
2.1. Credit to banks and financial institutions.	-1	-1	-1	-15	-18
2.2. Remunerated and non-remunerated float	418	71	-388	-804	-703
3. Other net assets	118	-84	137	571	742
3.1. Expense and products	166	147	89	209	611
3.2. Net Assets not classified	-48	-232	48	362	131
4. Operations of monetary stabilization	-854	1828	-1321	240	-107
5. Excess (-) or lacking (+) liquidity	-374	-208	-488	-641	-1711
III. DEMAND of MONETARY ISSUE	-575	-355	-271	2169	967

Taking into account the behavior of the observed monetary variables to November, the estimation of involvement of the real sector, of the external sector, as well as the estimation of closing of the fiscal variables (that include the projection of the needs of financing for the activities of reconstruction associated to tropical storm Stan), in the following is presented the estimation for the last trimester of 2005 and of the yearly closing, considering that the first three trimesters correspond to observed numbers.

As can be observed in the previous diagram, it would be expected that in the fourth trimester the NIR would show a decrease of US\$37.0 million, mainly derived of the service payment of the external public debt. Given the observed numbers to November, when the year ended it would be estimated that an increase of NIR of around US\$250.0 million, amount that would allow continuing the consolidation of the position of the external debt of the country.

Consistent with the behavior of the NIR and of the monetary issue demand, in the fourth trimester the NIA of the *Banco de Guatemala* would monetize by Q2,464.0 million, while it would be expected that these at yearly closing will demonetize by Q1,033.0 million.



Considering the balance of the deposits of the central government to November 2005, as well as the estimation in the public finances of the needs of financing for the reconstruction activities of tropical storm Stan, it is expected that in the fourth trimester, the central government decrease its deposits by Q3, 122.0 million in the *Banco de Guatemala*. On this account, at the end of the year, the monetization generated by the central government would be Q1, 639.0 million. On the contrary, it is expected that at the end of the year the rest of the public entities would have demonetized Q876.0 million, with which the monetization generated by the non-financial consolidated public sector will be for Q763.0 million.

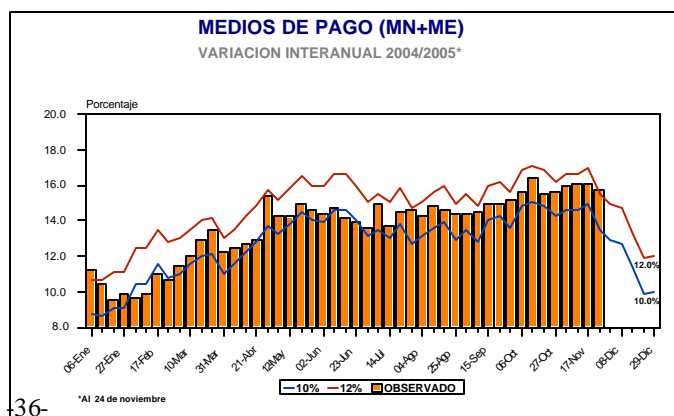
As to the position of the banks of the system, it would be expected that at the end of the fourth trimester said entities would increase their deposits in the central bank for Q819.0 million, this fundamentally due to the fact that the expected trajectory of bank fund raising during the last trimester. Derived from the above, it is expected that at the end of the year the banks would generate a demonetization for Q720.0 million.

Taking into account the amount and the interest rate of monetary stabilization operations and of investments in NIR, during the fourth trimester the cost of the monetary, exchange rate and credit policy would reach Q209.0 million, which would add an accumulated cost of Q611.0 million at the end of the year.

Consistent with the demand of monetary issue for Q2, 169.0 million, with the external origin demonetization for the equivalent to Q296.0 million and with the monetizing effect that the other headings would have that integrate the NIA of the *Banco de Guatemala*, in the fourth trimester would need a neutralization of liquidity for Q641.0 million, which means that the balance in OEMs would have to increase by said amount.

In that sense, at the end of the year the balance of the total monetary stabilization operations is at Q18, 691.0 million, of which Q13, 050.0 million correspond to the monetary stabilization operations made with the private sector.

Graph No. 34
Payment Means (MN+ME)
Inter-annual variation 2004-2006





D. PAYMENT MEANS²⁰

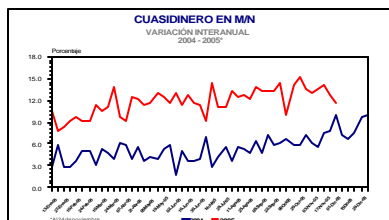
In the Monetary, Exchange Rate and Credit Policy for 2005 is estimated that, congruent with the growth of the economic activity, with the inflation goal and with the circulation velocity of money, the total payment means (M2) could grow between 10% and 12%, in inter-annual terms. To November 24, 2005, the inter-annual variation of the payment means was of 15.7%, which is located slightly above the expected range for this date (13.5% - 15.5%).

On their part the monetary aggregate M2 in national currency registered to November 24, 2005, a balance of Q63, 564.5 million, with an inter-annual growth rate of 14.8% (Q8, 184.0 million).

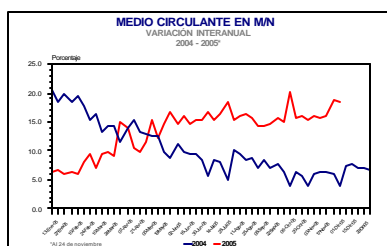
Among the components of the payment means of (M2) in national currency, the near-money registered an inter-annual growth rate of 11.6% (Q3, 478.2 million) and the circulating means of 18.4% (Q4, 705.8 million).

On their part the payment means (M2) in foreign currency registered to November 24, a balance equal to Q8,325.8 million, with an inter-annual growth rate of Q1,582.9 million (23.5%). In foreign currency, the near-money grew by an equivalent to Q1, 020.0 million (27.7%) and to the monetary deposits for the equivalent to Q563.0 million (18.4%), both in inter-annual terms.

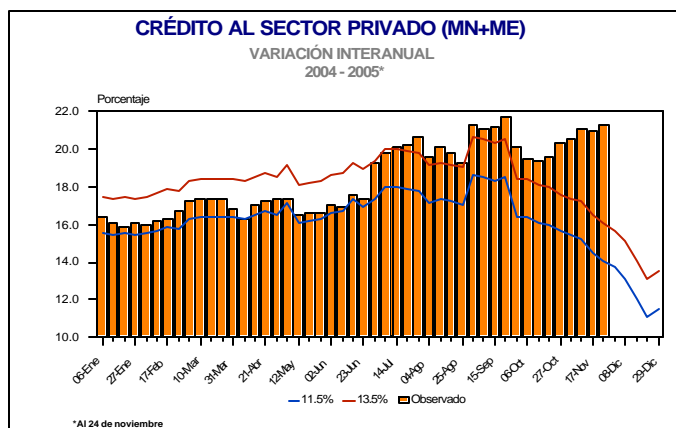
Graph No.35
Near-money in M/N



Graph No. 36
Circulating means



Graph No. 37
Credit to the Private Sector



E. CREDIT TO THE BANKS OF THE PRIVATE SECTOR²¹

1. GROWTH RATE

In the Monetary, Exchange Rate and Credit Policy for 2005 it is estimated that for the end of the year the banking credit to the private sector would reach an inter-annual growth rate of between 11.5% and 13.5%,

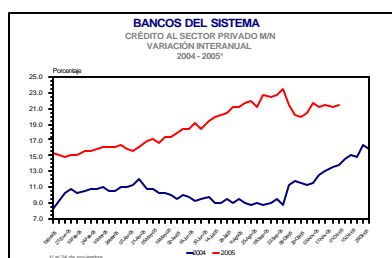
²⁰ Does not include the entities that were requested to declare bankruptcy.

²¹ Does not include the entities that were required to declare bankruptcy.

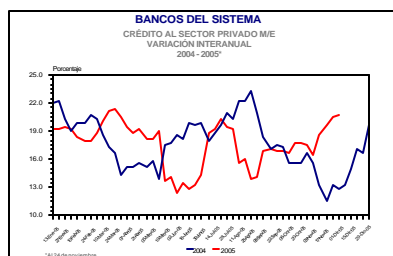
consistent with the payment means growth, with the inflation goal and with the expected economic growth.

To November 24, 2005, the inter-annual variation of the banking credit of the private sector was at 21.3%, which is located above the upper limit of the expected range for that date (14.1% - 16.1%).

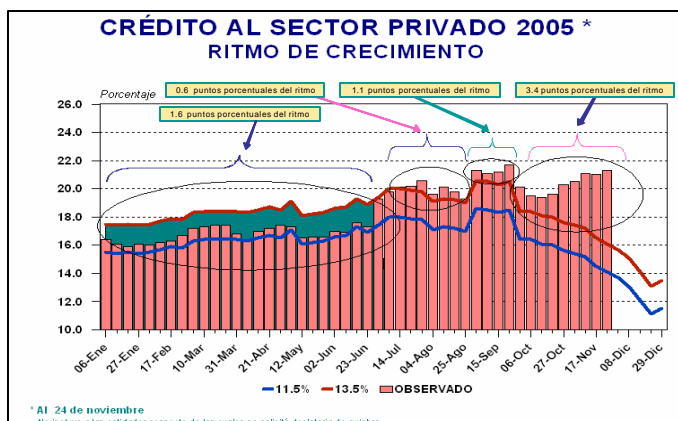
Graph No. 38
Banks of the System



Graph No.39
Banks of the System



Graph No. 40
Credit to the Private Sector/ Growth Rhythm



Regarding the credit to the private sector in national currency, this was at Q34,917.2 million, with an inter-annual growth rate of 21.4% (Q6,157.1 million). On their part, the credit to the private sector in foreign currency registered a balance equivalent to Q11,776.3 million, with an inter-annual growth rate of 0.8% (Q2,026.4 million).

It is worth indicating an increase of total credit to the private sector over the upper limit of the estimated corridor, which began evidencing itself in the second week of July, 2005, situation that is associated with, in part, the effect that is derived of credits that some banks would extraordinarily grant, whose relative weight is important in the financial intermediation in the country. Particularly, three events were observed: the first on June 30, the second on October 27 and the third on November 10, when extraordinary increases were observed in said variable for Q358.0 million; Q557.8 million; and, Q768.0, million, respectively. In that sense, when observing the nature of the banking credit to the private sector granted on the dates indicated, the banks coincided with financing sectors of construction, communications and commerce, which represents 5.1 percentage points of the growth rate of said variable, therefore discounting these, to the last date the growth rhythm would be 16.5%. In a wider perspective, it is worth indicating that between January and June the credit evolved below the upper limit of the corridor in a magnitude of 1.6 percentage points, therefore the increase in said variable over the upper limit during the period of January to November is of 3.5 percentage points. The above, suggests that very close follow up must be given to the behavior of said variable, in order



to avoid it becoming a source of unbalance in the macroeconomics of financial risks.

Importance of the Credit to the Private Sector

The majority of the banking activities are related with the efficient assignment of the resources, function is essential to economic growth. When they are fundamental agents in the capital assignment, the banks stimulate economic growth. The modern economic literature suggests that an important correlation exists in the coefficient that relates the banking credit to the private sector and the gross national product per capita. In that sense, the countries with small banking sectors have lower economic development; therefore, the cited correlation is an unequivocal signal of the bond between financial development and the economic.

In the theoretic ambit, it is not clear in what direction the causality of the mentioned bond operates. In that sense, the financial development can give way to greater economic development when improving the savings assignment in the economy, but, on the other hand, the economic development, through the creation of efficient institutions and of the necessary infrastructure can foment financial development. Notwithstanding the above, empiric studies made by Levine and Zervos (1998)^a and Rajan and Zingales (1998)^b, show that a higher financial development give place to greater growth in the GNP, where it is inferred that financial development really induces economic growth. In that context, the solid banks that offer stable credit are highly important to economic development.

In developing countries, the proportion of banking credit as a source of business financing is more important than in advanced countries, where the capital market is more developed. In that sense, it is worth pointing out that international experience suggests that a financial sector based on stock exchange operations must be supported on a mature banking sector. According to Rojas-Suárez and Weisbord (1994)^c there exists a sequence in the development process in the banking and capital markets, given that the latter is developed once the first is fully established.

SOURCE: UNCHAIN THE CREDIT. How to widen and establish banking. Interamerican Development Bank, Washington, D.C., year 2004.

a/ Levine, Ross and Sara Zervos. 1998, Stock Markets, Banks, and Economic Growth. American Economic Review 88(3): 537-558.

b/ Rajan, Raghuram G. and Luigi Zingales. 1998. Financial Dependence and Growth. American Economic Review 88(3): 559-586.

c/ Rojas-Suárez, Liliana and Steven R. Weisbord (1994). Financial Markets Fragilities in Latin America: From Banking Crisis Resolution to Current Policy Challenges, Work Document No. 94/117 International Monetary Fund, Washington, D.C.

2. Credit portfolio for economic activity

To October 31, 2005 (last information available), without including the banks who were requested to declare bankruptcy, the credit portfolio of the banking system increased by Q5,384.7 million. It is worth indicating that 89.7% of the banking credit portfolio is concentrated in the sectors of *consumption and transfers; commerce; construction; industry and agriculture*.



In the corresponding to the variation of the credit portfolio for economic activity from January to October 2005, it is distributed in the following manner:

SISTEMA BANCARIO^{1/}
CARTERA CREDITICIA POR ACTIVIDAD ECONÓMICA
EN LOS PERIODOS QUE SE INDICAN
- Millones de quetzales y en porcentajes -

DESTINO	DICIEMBRE	OCTUBRE	VARIACIÓN ACUMULADA		ESTRUCTURA %	
	2004	2005	ABSOLUTA	RELATIVA (%)	DICIEMBRE	OCTUBRE
	(A)	(B)	B - A	B/A	2004	2005
Total	36,495.7	41,880.4	5,384.7	14.8	100.0	100.0
Agricultura, ganadería, silvicultura, caza y pesca	2,612.9	2,451.4	-161.5	-6.2	7.2	5.9
Explotación minas y canteras	7.8	15.5	7.7	98.7	0.0	0.0
Industria manufacturera	3,476.9	3,225.1	-251.8	-7.2	9.5	7.7
Electricidad, gas y agua	608.7	770.2	161.5	26.5	1.7	1.8
Construcción	2,749.2	4,086.3	1,337.1	48.6	7.5	9.8
Comercio	6,961.4	7,042.5	81.1	1.2	19.1	16.8
Transporte y almacenamiento	228.6	496.4	267.8	117.1	0.6	1.2
Establecimientos financieros, bienes inmuebles y servicios prestados a las empresas	1,355.1	2,127.0	771.9	57.0	3.7	5.1
Servicios comunales, sociales y personales	946.6	937.9	-8.7	-0.9	2.6	2.2
Consumo, transferencias y otros	17,548.5	20,728.1	3,179.6	18.1	48.1	49.5
Consumo	9,314.8	11,216.8	1,902.0	20.4	25.5	26.8
Transferencias	7,008.5	8,373.6	1,365.1	19.5	19.2	20.0
Otros	1,225.2	1,137.7	-87.5	-7.1	3.4	2.7

1/ No incluye bancos respecto de los cuales se solicitó la declaratoria de quiebra.

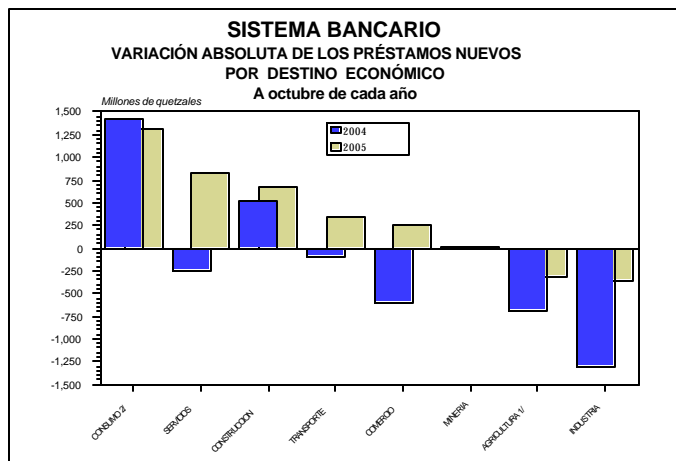
It is important to comment that the accumulated growth that was observed during the December 2004-October 2005 period is the highest observed in the last years, which in good part obeys the dynamics observed by the financing granted to the *consumption* and *construction* sectors. In effect, in the referred period the credit to consumption grew by 20.4%, destined to transfers by 19.5% and the heading of *others* decreased by 7.1 %, which meant that the headings of *consumption*, *transfers* and *others* would grow at a rate of 18.1%. On the other hand, the credit to the *construction* sector grew by 48.6%. Within the financing of this last sector, highlights the credit granted in *housing*, which represented around 63% of the total of the credit granted in the *construction* sector. Additionally, it is important to comment that the



interest rate that is applied to the *construction* sector, to October 2005, was around 13.6%, rate similar to the asset rate, weighted average, applied for the banking system (12.7%).

Graph No. 41
Banking System

Absolute variation of the new loans by economic destiny



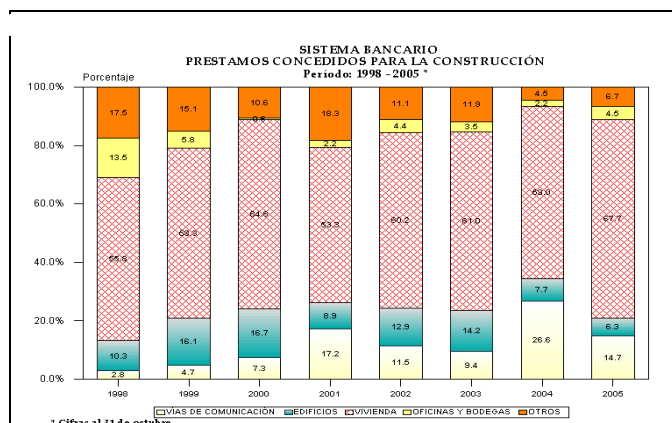
3. New Loans, extensions and renewals

To October 31, 2005 (last information available), the amount of new loans, that includes extensions and renewals ascended to Q24,453.6 million, amount higher by Q2,692.9 million (12.4%) to the registered in the same period the year before.

The amount of the new loans reflects, on the one hand, the increase of financing channeled to the consumption (Q1,305.0 million); the services (Q820.4 million); to construction (Q665.8 million); transportation (Q336.8 million); commerce (Q253.5 million); and, mining (Q3.1 million); as well as the reduction that registered the channeled financing to the industry (Q370.4 million); and, agriculture (Q321.3 million).

Graph No. 42
Banking system

Loans granted for construction



As is observed in the graph, it is important to reiterate that during the last two years, the credit to consumption and construction were the most dynamic sectors of credit activity of the country.

Given the important growth that the financing of the construction sector has showed, it is convenient, to highlight the disaggregate manner of integration of the loans granted to said sector. As is observed in the graph, within the financing to the construction, the resources have greatly been assigned to the housing sub sector, which represents on average, during the 1998-2005 period, 60% of the total for new loans; following in order of importance, the channeled financing for communications infrastructure with 11.8% and financing for building with 11.6%.

Graph No. 43
Inflation expectations
for December 2005



Graph No. 44
Inflation expectations
to December 2006



F. SURVEY OF INFLATION EXPECTATIONS FOR THE PANEL OF PRIVATE ANALYSTS

The inflation expectations are defined as the public belief of future behavior of prices in the economy. The inflationary expectations that for a certain period the economic agents can form, in some circumstances, substantially influence (independently of the behavior of the economic fundamentals), in the determination of the inflation rates that are finally observed in that period.

According to the expectations survey of inflation by the panel of private analysts (EEI)²², made in November 2005, the surveyed foresee that for December of the present year the inflationary rhythm will be at 10.17%, percentage higher to the established goal in the Monetary, Exchange Rate and Credit Policy for 2005 (4.0% - 6.0%). It is important to highlight that the inflation expectations have been increasing associated to the rise in the international price of oil and, in November, the increase in prices provoked by tropical storm *Stan*.

On their part, the private analysts estimate that the inflation for December 2006 will be at 8.70%.

G. MONETARY CONDITIONS INDEX -MCI-

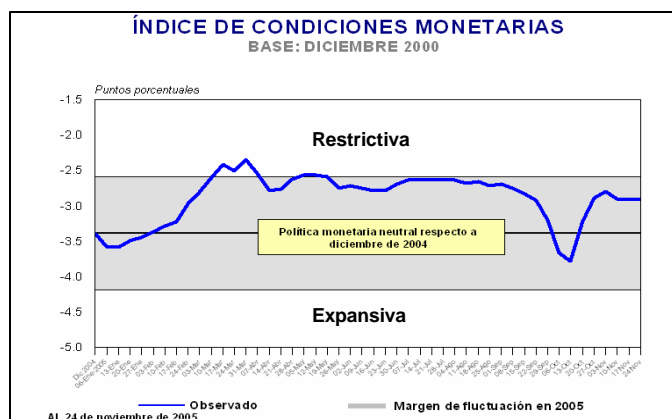
The Monetary Conditions Index –MCI- is an indicator that is calculated taking into consideration the changes that the interest rate and the exchange rate experiment regarding a predetermined base year. The

²² Monthly survey directed to national and international private analysts, knowledgeable of the operative procedures of the monetary policy, that allows measuring the impression of these regarding the future evolution of the inflationary rhythm in Guatemala.



interpretation of the MCI is based on the concept that the relation between the exchange rate and the interest rate can indicate if the monetary policy has been more or less restrictive. In the Monetary, Exchange Rate and Credit Policy for 2005, for the follow up of said indicator a corridor whose central point is the value of the MCI for 2000 was established (base year) and its upper and lower values were located at $(\pm) 0.8$ percentage points²³ regarding the central value indicated; a value of the MCI higher to the referred corridor is interpreted as the presence of a restrictive monetary policy; whereas a lower value of the corridor is interpreted as a presence of an expansive monetary policy.

Graph No. 45
Monetary Conditions Index
Base: December 2000



When observing the MCI between December 31, 2004 and March 31, 2005, is an ascending behavior, due to the fact that the nominal appreciation of the exchange rate was not compensated by a decrease in the interest rate, which brought about that said index during some weeks would be over the estimated corridor; however, this behavior was reverted as of April 2005, due to the fact of a lesser appreciation of the nominal exchange rate, as of November 24, 2005 the MCI was within the tolerance margin established, which allows inferring that the monetary policy in the greater part of the period was neutral.

III. MACROECONOMIC AMBIT

A. EXTERNAL SECTOR

1. The world economy in 2005

According to the International Monetary Fund (IMF)²⁴, after the temporary deceleration in 2004, the

²³ The 0.8 percentage points correspond to a Standard deviation of the Monetary Conditions Index (MCI) registered on average during the years 2003 and 2004.

²⁴ IMF World Economic Outlook. September 2005.



world economy recovered the growth rhythm in the first trimester of the current year and it is estimated that for 2005 the global growth is at 4.3%. It is important to indicate that the greater contribution of the performance of the Gross National Product -GNP- came from the services sector that compensated the slow growth observed in the manufacturing and commercial sectors. On the other hand, in the second trimester, derived of the rise in oil prices, suggested negative signals that provoked the fall of some important indicators and the weakening of the trust of investors and businessmen in great part of the main countries. Notwithstanding the above, the manufacturing sector as well as the commercial sector began a strengthening and the main indicators show improvement; however, the rise continues in the oil prices and the catastrophic effects of hurricane Katrina could affect both sectors. It is worth indicating that that economic expansion would affect both sectors. It is worth indicating that the economic expansion during 2005 continues being dominated by the growth in the United States and in the People's Republic of China, where the performance of the economic activity has surpassed the expectations.

Within the regional analysis of the world economy, the Gross National Product of the United States shows moderate growth that, however, is foreseen as the highest of the G-7, with a rate of 3.5%, supported by the solid increase of the productivity and by the constant improvements of the employment market conditions. Notwithstanding, the perspective in the short term has been dampened by the losses caused by hurricane Katrina, that points to being the most costly natural disaster in the last years. On the other hand, it is estimated that the deficit in current account would reach 6.1% of the GNP, level higher by 0.3% to the projected in April of that same year.

In the area of the euro, although the data observed is consistent with the recovery of the economic activity in the second semester of 2005, the growth prognosis of the GNP shows a tendency toward the fall (1.2%). This level is influenced by political aspects, like the rejection of the constitution of the European Union (EU) on behalf of France and Holland, as well as by the disagreement in the budget for the EU, which until now has had a negative effect on the trust in the financial



market. Also, the existence of risk continues influencing the fall of growth, given the weak demand and little domestic resistance before external shocks. The economic performance in the area of the euro continues to be diverse; the domestic demand in Spain and France has been relatively strong, while the decrease of the net exportations has reduced the growth. On the other hand, the domestic demand in Italy and Germany has been considerably weaker; however, the product of Germany has been moved by its strong net exportations.

The Japanese economy showed a rebound in its economic activity during the first trimester of 2005, which, according to data recently observed, continued moderately in the last months of the year, and according to the prognosis of the IMF, the GNP is expected to grow to 2.0% in 2005.

Although the growth expectations in emerging economies and developing countries remain invariable at 6.4% for 2005, these register substantial changes between the regions and the countries. In emerging economies in Asia, the People's Republic of China expects to exceed the expectations with a growth close to 9.0%. On the other hand, India presents data of a robust growth with a continued expansion in services, including technological information and an accelerated industrial production, so the growth of the economy is expected to be 7.1% in 2005. On the other hand, in the majority of countries the economic activity has decreased, affected mainly by the increase in oil prices.

On the other hand, the countries of the Western Hemisphere²⁵, the growth of the GNP, after a strong rebound, have fallen and it is estimated that for 2005 will be 4.1% (5.6% in 2004). The deceleration in growth is particularly present in Brazil, as a result of the monetary adjustment in order to contain the inflation, which foresees that the growth rate of the GNP will surpass 4.9% in 2004 to 3.3% in 2005. On the other hand, the economic growth in Argentina has lost its strong momentum from last year when it was 9.0%, but it still remains robust, since it is foreseen that it will be 7.5% in 2005. In Mexico, the growth behaved

²⁵ According to the International Monetary Fund (IMF), within the concept of "Western Hemisphere" the following countries are included: Antigua and Barbuda, Argentina, The Bahamas, Barbados, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Granada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Dutch Antilles, Nicaragua, Panama, Paraguay, Peru, St. Kitts and Nevis, Santa Lucia, San Vicente and the Grenadines, Surinam, Trinidad and Tobago, Uruguay and Venezuela.



differently than the expected during the first semester of 2005 and the growth prognosis is 3.0%, reflecting the low in the industrial production of the United States and in the exportations of automobiles, also of the weakening of the agricultural production.

According to the IMF, in Central America, the growth rhythm of the GNP has been mainly reduced by a lesser demand of the United States. The growth prognosis in 2005 is kept at 3.2% and it is considered that the ratification of the Free Commerce Treaty between Central America, Dominican Republic and the United States (DR-CAFTA) will be an impulse for the growth in the next year. On the other hand, due to the natural disasters that affect the region, it is foreseen there will be economic losses for various sectors, especially the agricultural.

As for the countries in the Middle East, the increase in production and in the prices of oil continue supporting the growth of the GNP, backed by the notable improvement in the position of current and fiscal accounts. This reflects in the growth prognosis of the IMF of 5.4% for the current year in said region.

The Community of Independent States, in general terms, has had a firm advance, benefiting from the favorable evolution of the market of Basic products, of the strong salary increases and of the quick expansion of the money offer and of credit. However, after a notable deceleration in 2004, the growth of the real GNP continued decreasing in 2005, going from 8.4% in 2004 to an estimation of 6.0% for 2005.

For the African region of the Sub-Sahara, the IMF foresaw a growth of the product of 4.8% for 2005, 0.4% less than the estimated in April. The above reflects, in part, the abrupt fall in the oil production in Nigeria.

On the other hand, a deceleration in world commerce is foreseen of commodities and services in 2005, since it is estimated it will grow 7.0%, while in 2004 it grew 10.3%. According to the IMF, in order to strengthen the flows of commerce of the international community it must liberalize the commerce in a frame of Doha Rounds, especially in the agricultural sector.



The oil prices have maintained a rise and at the end of October the barrel was quoted at US\$62.00²⁶, while the futures prices have been moved next to the prices of immediate delivery, creating more uncertainty on the stability in the market in the long term, slightly increasing the world inflationary rhythm.

In the majority of industrialized nations the subjacent inflation appears contained as well as the inflationary expectations; however, in large part in the emerging markets the inflationary pressures have increased in 2005.

The conditions in the financial markets continue to be benign, since the long term interest rates continue low all over the world. The asset markets continue stable, supporting themselves in their strong profits and solid financial status of the corporations. On the other hand, the emerging financial markets are more favorable each time and reflect economic improvement and the increase in long term investments.

Last, it is worth indicating that the strong and positive world growth of the first semester of 2005 was compensated by the weak growth of the second trimester, in part reflected by the adverse impact of the rise in oil prices; however, it is expected that the economic expansion be raised in the second half of the year, sustained by the macroeconomic policies and the favorable conditions of the financial markets, especially by the low interest rates in the long term and by the solid corporate financial statements.

²⁶ Immediate delivery price of West Texas Intermediate.



**ECONOMIC AND INFLATION GROWTH
PER REGIONS AND SELECTED COUNTRIES
EXPECTATIONS FOR 2005
(Percentage Variation)**

ECONOMIC GROWTH	2004***	2005**	2005***
World Economy	5.1	4.3	4.3
Advanced Economies	3.3	2.6	2.5
United States of America	4.2	3.6	3.5
Area of the euro	2.0	1.6	1.2
Japan	2.7	0.8	2.0
Emerging economies of Asia*	8.2	7.4	7.8
People's Republic of China	9.5	8.5	9.0
Emerging markets and developing countries	7.3	6.3	6.4
Africa	5.3	5.0	4.5
Mid East	5.5	5.0	5.4
Western Hemisphere (Latin America and the Caribbean)	5.6	4.1	4.1
Argentina	9.0	6.0	7.5
Brazil	4.9	3.7	3.3
Chile	6.1	6.1	5.9
Mexico	4.4	3.7	3.0
Venezuela	17.9	4.6	7.8
Central and Eastern Europe	6.5	4.5	4.3
Community of Independent States	8.4	6.5	6.0
Volumen of Commerce	10.3	5.4	7.0
INFLATION			
Advanced Economies	2.0	2.0	2.2
United States of America	2.7	2.7	3.1
Area of the euro	2.1	1.9	2.1
Japan	0.0	-0.2	-0.4
Western Hemisphere (Latin America and the Caribbean)	6.5	6.0	6.3
Emerging economies of Asia*	4.0	3.7	3.9
People's Republic of China	3.9	3.0	3.0
Countries of the Community of Independent States	10.3	11.4	12.6

* Includes Asia in development, the economies of Asia recently industrialized and Mongolia.

**Source: International Monetary Fund (IMF). World Economic Outlook, April 2005.

***Source: International Monetary Fund (IMF). World Economic Outlook, September 2005.

**2. Balance of estimated payments to
December 2005**

a) Current account

For 2005 it is estimated that the current account of the payments balance for Guatemala will show a deficit balance of US\$1,302.6 million, which would imply a deficit as a portion of the GNP of 4.1%, less than the registered in 2004 (4.4%). Said deficit would be financed with a surplus of the capital and financial account of US\$1,552.6 million, therefore the estimated



gains in the international monetary reserves would be US\$250.0 million.

The balance in current account will be the result of the deficit in commercial balance of US\$5,460.3 million and in the surplus, in the balance served of US\$665.4 million, as well as the net current transfers of US\$3,492.3 million.

The commercial balance, regarding December 2004, would be determined by an increase in the FOB value of the exportations of US\$432.1 million (14.7%) and an increase in the CIF value of importations of US\$1,019.5 million (13.1%).

The FOB value of exportations would be of US\$3,370.8 million, greater by 14.7% to the registered in 2004. In said result the determinant would be the value of the exportations of coffee, which would be at US\$467.3 million, higher by US\$141.6 million (43.5%) to 2004, which would be explained by the increase in the mean price as well as in the exported volume. In effect, the mean price of exportation per quintal would increase by US\$75.69 in 2004 to US\$105.56 in 2005, while the exported volume in quintals would increase when surpassing 4,303.1 thousand in 2004 to 4,426.8 thousand in 2005.

The increase in the international price of grain is explained, according to the International Coffee Organization, OIC (for its Acronym in Spanish), by a deficit in world offer of the grain originated by the fall in world production of coffee, especially Brazil and Vietnam. In effect, the poor climate in Brazil, affected the production due to low temperatures and the excess of rainfall in the main production states, while in Vietnam a drought affected the coffee plantations. Said behavior is reflected in the coffee inventories that the New York Stock Exchange has registered the lowest levels since July of 2003.

The value of the exportations of sugar in 2005 are expected to reach US\$205.6 million, greater by US\$14.5 million (7.6%) to the registered in 2004, situation, mainly explained by the increase of US\$0.85 (11.4%) in the mean price of exportation, since the exported volume would decrease by 3.4% regarding the previous year. In effect, the mean price of exportation per quintal would increase by US\$7.43 in 2004 to



US\$8.28 in 2005, the exported volume, in quintals would decrease when going from 25,713.9 thousand in 2004 to 24,833.2 thousand in 2005. The increase in the world price of the sweetener is mainly due to the fact that Brazil has reduced its offer, since part of the harvest has been destined to the production of ethanol, which is a consequence of the rise in international oil prices.

The value of banana exportations in 2005 would be US\$237.1 million, greater by US\$3.6 million (1.5%) to the registered the year before, which would explain the increase of 1,679.6 thousands of quintals (8.1%) in the exported volume, since the mean price of exportation per quintal, would decrease when going from US\$11.23 in 2004 to US\$10.55 in 2005. The increase in the exported volume is fundamentally explained because the production in the new planning areas of the pacific coast reached their maximum yield points.

As for the cardamom, the value of the exportations in 2005 are projected in US\$70.9 million, lower by US\$2.9 million (3.9%) to the registered in 2004. This result would be explained, in part by the decrease in mean price of exportation per quintal, when going from US\$118.84 in 2004 to US\$94.79 in 2005, even though the exported volume in quintals would increase by 621.0 thousand in 2004 to 748.0 thousand in 2005. The behavior in the international price of cardamom is mainly due to the accumulation of inventories of this product in the countries of the Middle East.

On their part, the value of oil exportations would be US\$226.4 million, higher by US\$47.0 million (26.2%) to the registered the year before. This increase would be sustained by the increase in the mean price of exportation per barrel, which would go from US\$26.52 in 2004 to US\$35.98 in 2005, since the exported volume for 2005 would decrease by 473.4 thousand barrels (7.0%). The increase in the international oil prices originated from the world deficit of crude oil derived from the increase in the demand of oil in the greater economies in expansion, mainly in the United States, as well as in the People's Republic of China; and, from the lack of elasticity in the world offer regarding the price, that coincided with the inability to



work the oil platforms in the Gulf of Mexico, due to the effects of hurricanes Katrina and Rita. Regarding the exported volume, this was influenced by the slowing down in national production, due to the lower yield in the oil wells.

The value of the exportations of other products would be of US\$2,163.5 million, greater by US\$228.3 million (11.8%) to the registered in 2004. This result is due to the foreseen increase of exportations, in Central America as well as in the rest of the world, which would increase by 11.9% and 11.6%, respectively. The above is attributed to greater demand, associated to the recovery of the world economic activity.

The CIF value of importations for 2005 would be of US\$8,831.1 million, greater by US\$1,019.5 million (13.1%) to the registered the year before. In this growth the highlight is the increase in the headings of fuel and lubricants (43.9%)²⁷; construction material (21.9%); machinery, equipment and tools (9.7%); consumer goods (8.1%); and raw materials and intermediate products (6.1%). It is worth highlighting that the considerable increase in the importation of fuel and lubricants due to the rise in oil prices and its derivatives.

On the other hand, the services balance in 2005 would register a surplus balance of US\$665.4 million, lower by US\$13.5 million (2.0%) to the registered the year before. Said result would be determined by the surplus of US\$1,033.7 million in the non-factorial services and because of the deficit of US\$368.3 million in factorial services. The surplus of the non-factorial services obeys the greater increase due to tourism and travel. On the other hand, the deficit in factorial services is mainly explained by the increase in the external debt service of the non-financial public sector.

Regarding the net current transfers, these would register a surplus balance of US\$3,492.3 million, mainly derived of the continuous growth of the net increase in the family remittances, which is estimated would reach the amount of around US\$2,940.0 million.

²⁷ The increase in the international oil price and its derivatives was an average of 36.0%. It is worth indicating that if the price of these products had not registered important highs in 2005, the deficit in current account, regarding the gross national product, would have been lower by one percentage point.



b) Capital and financial account

The capital and financial account of payments balance would register in December 2005 a surplus balance of US\$1,552.6 million, less by US\$244.4 million, when registered the previous year.

The capital and financial balance would be the result of the surplus balances of the transfers of capital and the account of private capital, as well as the deficit registered in the account of official and banking capital. In effect, the transfers of capital would register in 2005 a surplus balance of US\$139.1 million, greater by US\$3.8 million (2.8%) to the registered the year before.

The official and banking capital would register a deficit balance of US\$61.7 million in 2005, a deficit balance contrary to the surplus of US\$249.3 million registered in 2004. Said result would be explained, on the one hand, by the increase, by the disbursement of non-financial loans to the public sector for US\$165.0 million; and, on the other hand by the expenditures, due to the amortizations of external debt of the non-financial public sector for US\$197.0 million; due to the payment of the foreign debt of the *Banco de Guatemala* for US\$0.8 million; and, because of the net amortization of bonds with non residents for US\$28.9 million.

Regarding the account of private capital, this would register a surplus balance of US\$1,475.2 million, greater by US\$62.8 million (4.4%) to the registered in 2004. Said surplus would be explained by the income due to direct foreign investment for US\$197.8 million; due to the net income of mid and long terms of capital for US\$591.8 million; and, due to the net income of short term capital for US\$685.6 million.

Derived from the operations in the current account and in the capital and financial account of the payments balance, it is estimated that for 2005 there will be an increase of net international monetary reserves for US\$250.0 million.



PAYMENTS BALANCE

YEARS 2004 - 2005

-In millions of US Dollars-

CONCEPT	2004 ^{d/}	2005 ^{e*/}	Variations	
			Absolutes	Relatives
I. CURRENT ACCOUNT (A+B+C)	-1,188.3	-1,302.6	-114.3	9.6
A. COMMERCIAL BALANCE	-4,872.9	-5,460.3	-587.4	12.1
1.Exportations FOB	2,938.7	3,370.8	432.1	14.7
Main Products	1,003.5	1,207.3	203.8	20.3
Other products	1,935.2	2,163.5	228.3	11.8
2.Importations CIF	7,811.6	8,831.1	1,019.5	13.1
B. SERVICES	678.9	665.4	-13.5	-2.0
1. Factorials, Net	-356.5	-368.3	-11.8	3.3
2. No Factorials, Net ^{1/}	1,035.4	1,033.7	-1.7	-0.2
C. CURRENT TRANSFERS (Net)	3,005.7	3,492.3	486.6	16.2
II. CAPITAL Y FINANCIAL ACCOUNTS (A+B+C)	1,797.0	1,552.6	-244.4	-13.6
A. TRANSFERS OF CAPITAL	135.3	139.1	3.8	2.8
B. OFFICIAL AND BANKING CAPITAL ACCOUNT	249.3 ^{ai/}	-61.7	-311.0	-124.7
C. PRIVATE CAPITAL ACCOUNT ^{2/}	1,412.4	1,475.2	62.8	4.4
III. PAYMENTS BALANCE	608.7	250.0		
Net Reserve (- increase)	-608.7	-250.0		

^{1/} Include March for US\$490.8 million for 2004 and US\$485.0 million for 2005

^{2/} Include Errors and missions

^{ai/} Include US\$330.0 million of income for Treasury Bonds placement in the international market.

^{d/} Preliminaries

^{e*/} Estimate of closing

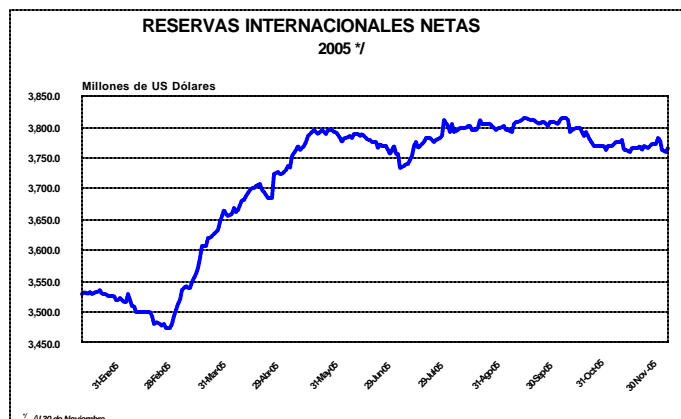
Balance Current Account/ GNP -4.4% for 2004 and -4.1% for 2005

3. Net International Monetary Reserves

To November 30, 2005, the net international reserves –NIR- were at US\$3,766.4 million, which means an increase of US\$238.4 million regarding the observed level to December 31, 2004. Said increase is the result of income from foreign currency for US\$567.8 million and other income for net operations of US\$133.1 million. Concerning the income, these are integrated by the purchases made by the *Banco de Guatemala* in the Electronic Negotiation of Foreign Currency System -SINEDI (for its acronym in Spanish) for US\$466.6 million and for the disbursements received by the Non-financial public sector for US\$101.2 million. Regarding the expenditure, these



Graph No. 46
Net Internacional Reserves



are mainly originated by the payment of service of the external public debt for US\$269.0 million, of which US\$268.4 million correspond to the Non financial public sector and US\$0.6 million to the *Banco de Guatemala*; and, for the payment of capital and interest of the expressed bonds in US dollars for US\$193.5 million. Regarding the movement of other net operations, it is worth pointing out the income due to interest perceived on investments of the NIR for US\$71.6 million, for royalties on oil exploration for US\$69.4 million, of the increase of the balance in the banking float accounts in foreign currency for US\$22.7 million and other net expenditures for US\$30.6 million.

B. REAL SECTOR: ECONOMIC ACTIVITY IN 2005

1. General Aspects

The deceleration that the growth rhythm of the national economic activity manifested since 1999 was reverted in 2004; tendency that continued in 2005, year that the Gross National Product –GNP- in real terms is estimated will grow 3.2% (2.7% in 2004). It is worth indicating that this growth rate, although positive, continues to be inferior to the average rate registered in the decade of the nineties (4.1%), but superior for the second consecutive year to the growth rate of the population (2.5%)²⁸. Said behavior is founded, in the external order, on the favorable growth that is foreseen for the economy of the United States, which will grow over the average growth rate that is foreseen for advanced economies (2.5%), as well as for the rest of the main country commercial partners of Guatemala²⁹; and, in the internal order, in the maintenance of the macroeconomic stability, based on the application of a prudent monetary policy, strongly supported by a disciplined fiscal policy, as well as in the unappreciable effect had by tropical storm Stan in the production flow of the country, that was computed according to the methodology of national accounts.

²⁸ Estimation made by the National Statistics Insuper –INE (for its acronym in Spanish), based on the Population Census of 2002.

²⁹ According to estimations of the International Monetary Fund (IMF) in 2005 the economy of the United States will grow 3.5%; that of Mexico 3.0%; that of El Salvador 2.0%; that of Honduras 4.2%; that of Costa Rica 3.2%; and, that of Nicaragua 3.5%, among others.



ESTIMATION OF THE EFFECTS IN THE GNP FOR 2005 CAUSED BY TROPICAL STORM STAN

a. Main methodological aspects :

According to *Manual para la Estimación de los Efectos Socioeconómicos de los Desastres Naturales* (Manual for the estimation of socio-economic effects for Natural Disasters) made up by the Economic Commission for Latin America and the Caribbean -CEPAL-, the evaluation for a natural disaster must begin with an exhaustive process of quantitative information recollection and diverse antecedents that allow, on the one hand, appreciate the prevalent conditions before the disaster and, on the other hand, the reach and magnitude of the damage and secondary effects of it. For the effect, the analysis must be based on information sources such as: strategic informants, written means, cartography, recognition missions, surveys, secondary data, distance interpersonal communication, aerial photography and remote sensor images.

According to said manual, it is necessary to quantify the damages and losses per sector. As for the damages, these are defined as those provoked by the disaster in the undivided estate of public and private capital of the country, the partial or total destruction of capital in different economic, social and infrastructure sectors, as well as in the environment. Regarding the losses, these are defined with the alteration in the flows that generate production and income, including the greater expenses and costs of diverse types, produced by the destruction.

b. Socioeconomic effects of Tropical storm Stan^a

The information of the diagnosis elaborated by CEPAL points out that the effect of the phenomenon in the economy of the country would be minimal, as long as the agricultural subsistence production, according to said diagnosis, were greatly affected; however, it is highlighted that the report that the store did have a negative potential in altering life conditions of important sectors of the Guatemalan population, whereas the effects impacted in the population groups, the productive and ethnic, were the most vulnerable.

In the CEPAL report it is estimated that the costs reach Q7,418.0 million, of which Q3,160.0 million correspond to damages and Q4,259.0 million to losses.

According to the report, of total losses and damages, around 15.1% (Q1,131.3 million) correspond to the social sector which includes housing, education and health; 27.3% (Q2,042.3 million) to farming, industry, commerce and tourism; 45.4% (Q3,396.3 million) to infrastructure, that includes water and hygiene, electricity and transportation; 4.1% (Q308.0 million) to the environment; and 8.0% (Q594.8 million) to emergency expenses.

c. Losses in National Infrastructure

According to the reference manual, the losses in undivided estate, computed as direct damage, will not be reflected in the gross investment of the year, since it deals with pre-existing destruction of assets. In the measure in which the process of restoration of assets is made, and depending on the availability of resources and of the ability of construction of the country, the gross investment of the following year would rise. In that sense, the damages caused to the infrastructure of the country will not affect the estimations of the GNP for 2005, due to the fact that this incorporates variables of flow, while the physical infrastructure, since it is a group of produced commodities in a previous period, form part of the undivided estate of capital; however, for 2006 the process of reconstruction would be incorporated to the corresponding economic activities, in the moment of its realization.

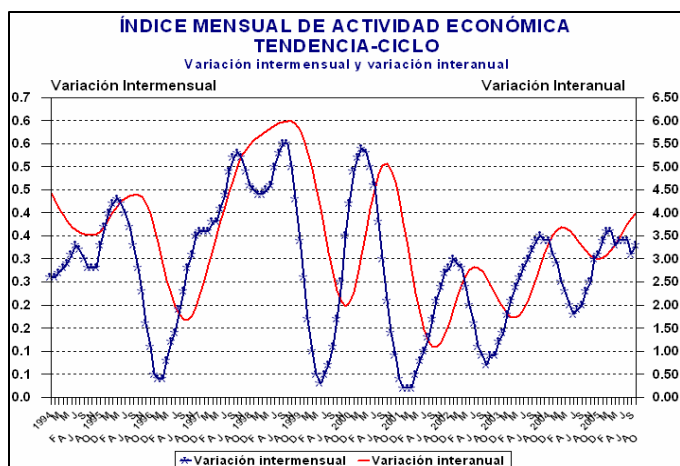
d. The effect of tropical storm *Stan* in the productive sectors

According to the *Ministerio de Agricultura, Ganadería y Alimentación* MAGA-, (Equivalent to the Department of Agriculture)- the affected production is focused in greater degree in small farms, mainly subsistence, as well as the small farm animal production, whose contribution is insignificant in the total production. Said activities are mainly associated with the production of corn (white and yellow), of beans, some vegetables (tomato, onion, potato, bell pepper), some planted fruit (watermelon, papaya, pineapple) and, in reduced number, the production of bovine cattle and domestic birds and, as for exportation products, sesame seed.

On the other hand, according to the available information, in the permanent plantations there were no significant losses registered. It is important to point out that the main agricultural productions like coffee; sugar cane and cardamom have kept a normal production process in the course of the year.

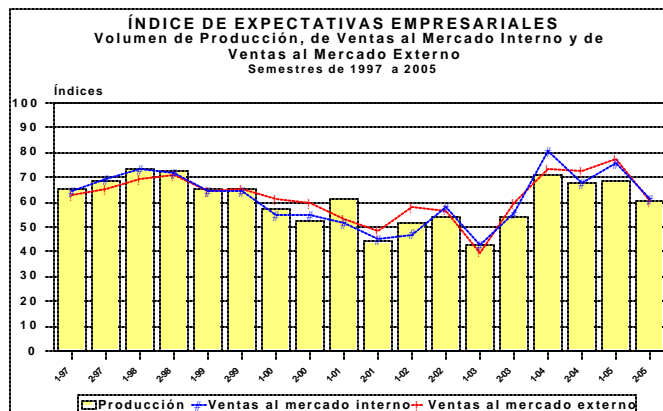
^a Notes On the effects of *Stan* in Guatemala. R. Zapata Marti. Focal Point of Disaster Evaluation, CEPAL. November 7, 2005. www.segeplan.gob.gt/stan/docs/NOTAS_PRELIMINARES_IMPACTO_STAN_GUATEMALA.DOC

Graph No. 47
Economic Activity of the Monthly Index
Cycle-Tendency



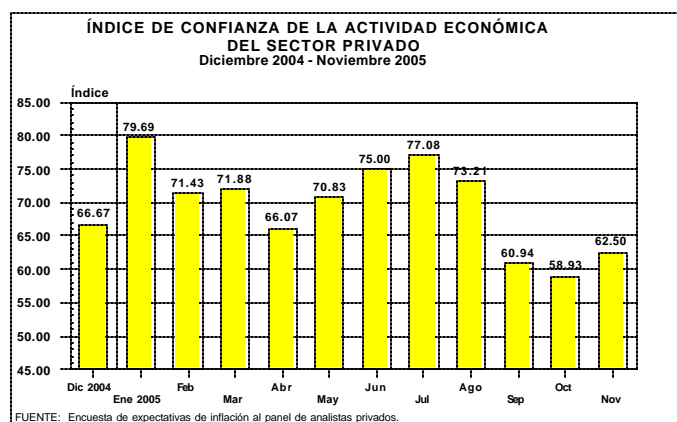
It is worth adding that if the price of international oil for the second year was constituted as an adverse factor to the national production activity, the impulse that continues showing the world economy fundamentally sustained in the economic growth of the United States and of the People's Republic of China, giving support to the expected growth of the Guatemalan economy. In that sense, what is observed if the increase of the international price of oil has transferred to the general level of prices, it still has not lessened the momentum of the national economic activity.

Graph No. 48
Business Expectations Index
Volume of production, of internal sales and of
External market sales



As to the monthly Index of Economic Activity – IMAE (for its acronym in Spanish) its cycle tendency, after registering a deceleration between May 2004 and January 2005, as of February began showing a growing behavior.

Graph No. 49
Trust Index of the Economic Activity
of the Private Sector



On their part, according to the results of the Business Opinion Survey³⁰ carried out every two months; March-April and August-September of 2005, the Index of Business Production Expectations³¹, shows a decrease when going from 68.9 in the first semester of 2005 to 60.5 in the second semester of the year. Also, according to the referred survey, a similar behavior is observed in the indexes of business sales expectations, in the internal as well as in the external markets.

According to the tendency of the Trust Index of the Economic Activity of the Panel of Private Analysts³², the expectations of economic reactivation during the first eight months of 2005 were kept over the registered in December 2004. In contrast, in the following months, from September to November the referred index was slightly below the observed level in

³⁰ Every semester a survey of the businessmen in the manufacturing industry, whose sample includes 400 industrial establishments, of which 60% are large (with more than 50 employees), 22% were medium sized (between 20 and 49 employees) and 18% are small (between 5 and 19 employees).

³¹ Built on the base of percentage of answers of the businessmen that indicate that their production would increase, minus the percentage of answers of the businessmen that indicate that their production will decrease. In the first survey of 2005 these percentages were of 49.7% and 11.9%, in the same order; so much so that the second surveys were of 38.4% and 17.5%, respectively.

³² The Economic Activity Trust Index by the Panel of Private Analysts has the purpose of measuring the perception of the economic analysts, in the current economic situation an in the business environment, as well as in the economic evolution of the country in the near future. It is worth indicating that the expectations of the panel of national and international economic experts are picked by means of the Inflation Expectations Survey –EEL- (for its acronym in Spanish), that from December 2003 has been made monthly by the *Banco de Guatemala* and whose results are published on its website on Internet.

Graph No. 50
Private Sector Expectations regarding
the annual growth of the Gross National Product
November 2004 – November 2006



December of the previous year, even though it is observed that in the month of November it began to recover.

Another indicator that is obtained from the opinion of the private analysts is the one regarding the estimation of growth of the GNP. In this regard, the analysts foresee that the national activity will increase the growth rhythm. In effect, according to the results of the EEI³³ the GNP will grow at a rate of 3.0% (2.8% in November 2004). It is worth noting that said prevision has been increasing in the last three months.

2. Gross national product due to origin of the production

On the part of the origin of production, for 2005, with the exception of the *mines exploitation and quarries* (that register a negative growth rate, although less than the year before), it is foreseen that positive behavior for the productive sectors, estimating that the *manufacturing industry; construction; and public administration and defense*, register more dynamic growth rates than the observed the year before.

As to the production of the agriculture, forestry, hunting and fishing (with a participation of 22.7% in the GNP), according to estimations provided by producer associations, guild members and public and private entities, are estimated that these experiment less dynamism regarding the previous year, when showing a growth rate of 2.4%, less than the 3.7% registered in 2004. Said behavior is mainly explained by the less dynamic growth rates than those of the previous year in the components of production of the agricultural sub-sector, particularly the case of exportation products and the industrial consumption products. In effect, in the case of these products a deceleration is foreseen in the production of sugar cane and of cardamom, and a standstill in the production of coffee, which will be countered, in part, by the increase in the production of banana. As to the internal consumption, it is expected that these have positive behavior, with the exception of

³³ It is important to highlight that the EEI of October was made after the passing of tropical storm *Stan*.



corn, whose production was affected by the fallout of tropical storm *Stan*.

It is important to point out that according to the information provided by the *Ministerio de Agricultura, Ganadería y Alimentación* (Equivalent to the Department of Agriculture) -MAGA-, the main exportation agriculture products like coffee, sugar cane and banana have kept a process of normal production in the course of this year, since the effects of the fallout of tropical storm *Stan* on the production of said plantations are marginal (0.13%, 0.24% and 0.16%, in the same order, regarding the numbers of production estimated for said products in 2005).

In the case of the coffee production, based on the information provided, by the *Asociación Nacional del Café -ANACAFÉ-* (National Coffee Association) is foreseen that a production of 4,500 thousand quintals in 2005, equal to the registered the year before, behavior that is mainly explained in the external order, by the excess offer of this product in the world and by the low prices in the international market; and, in the internal order, because the application of the working culture did not vary.

The production of cardamom, on its part, is expected that for 2005 it will grow 3.7% (27.5% in 2004). According to the *Asociación de Cardamomeros de Guatemala* (Cardamom producers of Guatemala) -CARDEGUA-, the lesser dynamism estimated is explained by the reduction in the international price of the aromatic, which is reflected in the mean price of exportation, that surpasses US\$118.84 per quintal in 2004 to US\$94.79 per quintal in 2005, due to the accumulation of inventory of said product in the Middle Eastern countries.

In the case of the production of banana, according to the appreciations of the *Compañía de Desarrollo Bananero, S.A.*, (Banana Development Company) -BANDEGUA- and of the *Compañía Bananera Guatemalteca Independiente, S.A.*, (Independent Banana Company of Guatemala) -COBIGUA-, it is estimated that for the current year a production of around 24.1 million quintals can be reached, registering a growth of 8.8% regarding the previous year (6.5%). The greater dynamism expected is explained because the new plantations of the southern part of the country,



that were rooted due to the recurring labor problems in the banana producing areas of the territorial division of Izabal, are reaching their maximum production level.

Regarding the sugar cane production, a growth of 0.2% is foreseen (10.0% in 2004). In effect, according to the information of the *Asociación de Azucareros de Guatemala* (Sugar Producers Association of Guatemala) -ASAZGUA- and of the *Centro Guatemalteco de Investigación y Capacitación de la Caña de Azúcar* (Guatemalan Center for Investigation and Training for Sugar Cane) -CENGICAÑA-, during the sugar cane harvest of 2004/2005 a production of 392.0 thousand quintals of sugar cane is expected, number higher by 0.8 million quintals to the registered in the harvest of 2003/2004 (391.2 million quintals). It is worth indicating that the planted area in 2005 was similar to the year before and the yield per *manzana* (area of land approximately equal to 1.73 acres) harvested increased slightly, due to the maintenance of the cultural labor and favorable climatic conditions in the producing zones.

In the case of internal consumption products, a growth of 4.6% (1.6% in 2004) is expected, giving as a result an increase of 7.1% in the other consumption products (2.0% in 2004), basically derived, of a greater production of fruit and vegetables, which are estimated at 7.8% and 9.3%, respectively (1.5% and 3.5% in 2004, in their order). On the other hand, the internal Basic consumption products, present a fall of 0.2% (growth of 0.8% in 2004), due to a reduction in the corn production. In effect, according to the information of the *Coordinadora Nacional de Productores de Granos Básicos* -CONAGRAB- (National Coordinator for Basic Grains Producers), it is estimated that the corn production will be contracted by 4.4% (growth of 0.5% in 2004), due to the losses provoked by the fallout of tropical storm Stan, which are estimated in about 1.9 million quintals (8.5% of the national production)³⁴.

In the case of the *manufacturing industry* (with a participation of 12.6% in the GNP) for 2005 a growth of 2.7% is estimated, higher than the observed in 2004 (2.3%), this being the highest registered in the last 7

³⁴ According to the information of the CONAGRAB, the production of corn was affected in the territorial divisions of San Marcos, Quetzaltenango, Retalhuleu, Suchitepéquez, Escuintla, Santa Rosa, Totonicapán, Sololá and Chimaltenango, which together cultivate approximately, 35.0% of the total production of the country.



years. Said behavior is associated, among other factors, to the growth in the demand of the Guatemalan industrial products in the United States market and, mainly Central American, derived of a positive performance of their economies. In effect, the value of the exportations of food products, fruit and preservatives and sugar toward the United States, in terms of dollars from that country, registered a growth of 10.9% (4.8% in an equal period of 2004), 22.7% (-0.2% to October 2004) and 30.0% (51.7% in an equal period of 2004), respectively, to October of the present year. As to the sales to Central America, the exportation of food products, with 11.6% (4.7% to October of 2004); chemical products, with 13.1% (13.6% in an equal period in 2004); construction material with 12.1% (33.5% to October of 2004); plastic articles with 20.2% (22.7% in an equal period in 2004); and fruit and preservatives with 36.8% (13.6% in 2004).

On its part, to October 2005, the importation of raw material and intermediate products destined toward the *manufacturing industry*, registered, in terms of US dollars, an increase of 1.0% (16.0% to October 2004); and the importation of capital goods for the industry grew 14.3% (20.1% to October de 2004).

The activity of the sector of *commerce in wholesale and retail* (with a participation of 24.8% in the GNP); it is estimated that for 2005 it will register a growth rate of 2.6% (3.2% in 2004), mainly explained by the deceleration in the growth rhythm foreseen in *agriculture, forestry, hunting and fishing*, as well as in the importation of goods.

The *mining and quarry* sector is foreseen to register a fall of 1.3% (8.3% fall in 2004). This behavior, according to the information of the *Ministerio de Energía y Minas* (Equivalent to the Department of Energy), is fundamentally determined by a fall of 9.2% in the production of oil (18.8% fall in 2004), due to the fact that the pressure of pumping from some wells is still depressed and that some have not begun working on the new wells.

Regarding the *electricity and water* sector, a growth of 3.5% (6.0% in 2004) is estimated. According to the information of the *Administrador del Mercado Mayorista -AMM-* (Wholesale market



administrator), to October 2005 registered a total gross generation of electric energy of 6,048.8 thousand MWH, volume that implies an increase of 2.5% regarding the same period of the previous year (6.3% in 2004). In said behavior the gross hydraulic generation has influenced, that to October 2005 has registered growth of 14.4% (16.1% to October 2004), while the gross thermal generation, to the indicated month, presented a fall of 4.1% (1.5% growth in the same period of 2004). It is worth adding that the lesser dynamism of the generation of electric energy coincided in some measure, to the fall in sales in El Salvador, which registered a fall in 67.6 thousand MWH equivalent to -17.4% (growth of 10.5% to October 2004).

The *construction* sector is estimated to register a growth of 3.0% (19.7% fall in 2004), mainly as a result of an increase of 31.0% in private construction (8.1% in 2004). On their part, the public construction continues showing negative behavior, located at -24.9% (36.0% fall in 2004).

In the private construction the positive behavior is associated, on the one hand, to the increase expected of 31.7% on the surface of construction³⁵ in the main areas surveyed in the Republic (5.0% in 2004) and, on the other hand, increase of the loans granted for private construction, to October 2005 had increased in Q726.4 million (68.1%) regarding the same period the year before (8.5%). In the case of public construction, the result is associated to the fact that the budget execution of the central government for the present year has focused on realizing activities of maintenance and rehabilitation of highway runs.

The *transportation, storage and communications* sector is expected to grow 8.4% in 2005 (9.2% in 2004), behavior explained, on the one hand, by the growth of 7.1% in the transportation sub sector (5.2% in 2004), associated to the increase registered in urban transportation and in the sub-urban load; and on the other hand, by the growth of 10.2% expected in the communications sub-sector (14.7% in 2004), derived by the activation of 345,680 new telephone lines (609,796 in 2004).

³⁵ Information obtained from the survey on construction for the municipalities of the metropolitan area: Guatemala, Mixco, Villa Nueva, Santa Catarina Pinula, San José Pinula, Villa Canales and San Miguel Petapa and to 33 municipalities of the interior of the Republic.



As for *banking, insurance and real estate* sector, it is foreseen that in 2005 a growth rate of 2.1% (2.2% in 2004) will be registered, associated to the behavior of the financial intermediation activity.

For the *housing property and private services* a growth rate of 2.5% and 3.6%, respectively, under the ones registered the year before (2.9% and 3.8%, in the same order). In the case of *public administration and defense*, a rebound of 2.3% is estimated (fall of 8.4% in 2004), explained, in part, by the creation of the new work positions in the *Ministerios de Educación and Gobernación* (Equivalent to the Department of Education and the Home Office).

**ORIGIN BY BRANCHES OF ACTIVITY OF THE GROSS NATIONAL PRODUCT
AT MARKET PRICES
YEARS 2004 - 2005
(Millions of quetzales from 1958)**

C O N C E P T	2004 p/	2005 e/	Variation Rates	
			2004	2005
Gross National Product	5,566.4	5,746.9	2.7	3.2
Agriculture, forestry, hunting and fishing	1,275.3	1,305.2	3.7	2.4
Exploitation of mines and quarries	27.9	27.5	-8.3	-1.3
Manufacturing Industry	704.2	723.2	2.3	2.7
Construction	72.8	74.9	-19.7	3.0
Electricity and water	247.0	255.7	6.0	3.5
Transportation, storage and communications	631.9	685.2	9.2	8.4
Wholesale and retail commerce	1,387.3	1,422.9	3.2	2.6
Banking, insurance and real estate	275.1	280.8	2.2	2.1
Property and housing	259.8	266.3	2.9	2.5
Public Administration and defense	350.7	358.7	-8.4	2.3
Private Services	334.6	346.5	3.8	3.6

p/ Preliminary Numbers

e/ Estimated numbers

Note: Due to approximations of some number there may be slight differences.



3. Gross Domestic Product per expenditure

It is estimated that the variables that integrate the GDP per expenditure, in real terms, except the investment of the government, will register positive growth rates in 2005.

It is expected that the domestic demand, constituted by the consumption, investment and stock variation, will register a growth of 3.7%, higher than the 3.0% shown in 2004.

It is estimated that the private consumption will register a growth rate of 4.6%, higher in 0.9 percentage points than the one observed in the previous year.

It is foreseen that in 2005 the expenditure of the consumption of the government, which includes remunerations and purchase of goods and services, will have a rebound in its behavior, while estimating a growth of 5.3% (-10.1% in 2004), which would be associated with a higher budgetary execution of the operational expenses of the central government.

In matters of investment, it is estimated that the gross geographical formation of fixed capital will register a growth of 6.4% (1.5% in 2004), as a result of an increase of 11.2% in the private investment (8.8% in 2004) and a fall of 17.8% in the public investment (24.0% of fall in 2004). The highest dynamism expected in the private investment, in real terms, is mainly due to the acceleration of 30.8% foreseen in private construction (8.0% in 2004); as well as to the growth of 8.9% estimated in the importation of capital goods (12.3% in 2004) to cover a higher demand of foreign goods, derived from the expectations of the enforcing of the FTA and from the consolidation of the *Unión Aduanera Centroamericana* (Central American Customs Conjunction). With regard to the behavior of the public investment, this is explained by the lower performance expected in the construction of roads and public works (-20.6%); this behavior is similar to the one of 2004 (-24.3%).

It is estimated that the foreign demand, constituted by the exportation of goods and services, will register,



in real terms, a growth of 0.2% (6.6% in 2004). In this case, it is important to mention that the foreign demand is being promoted by the performance of the economic activity of the United States of America and of the main commercial associates of the country.

It is estimated that in the foreign offer the importation of goods and services would register, in real terms, an increase of 3.5%, lower than the observed in the previous year (7.2%). Regarding the structure of the importations, in United States dollars, to October 2005, fuel and lubricants grew by 45.4% (13.6% during the same period of 2004); construction materials in 25.8% (6.2% in October 2004); capital goods by 11.2% (18.4% during the same period of 2004); consumption goods by 6.8% (12.2% in October 2004); and, prime materials and intermediate products in 1.4% (17.0% during the same period of 2004).

EXPENSES DEDICATED TO THE GROSS DOMESTIC PRODUCT TO MARKET PRICES
YEARS 2004 - 2005
(Million of quetzales of 1958)

C O N C E P T	2004 p/	2005 e/	Variation rates	
			2004	2005
1. Consumption expenses of people and non-profit private institutions	4,507.9	4,715.4	3.7	4.6
2. Expenses of the central government's consumption	441.3	464.7	-10.1	5.3
3. Gross geographical formation of fixed capital	610.1	648.9	1.5	6.4
Private	508.0	565.0	8.8	11.2
Public	102.1	83.9	-24.0	-17.8
4. Variation of stocks	278.8	227.5		
GROSS EXPENSE OF THE NATION	5,838.1	6,056.4	3.0	3.7
5. Exportation of goods and services	863.0	864.6	6.6	0.2
6. Low: Importation of goods and services	1,134.7	1,174.1	7.2	3.5
GROSS DOMESTIC PRODUCT	5,566.4	5,746.9	2.7	3.2

p/ Preliminary data

e/ Estimated data

Note: Due to approximation some numbers might show slight differences.



Employment

In order to obtain statistical information about employment in Guatemala, the *Instituto Nacional de Estadística (INE)* carried out the National Survey of Employment and Income 2004 (ENEI 2004), which collected information from the September - November 2004 period.

According to the results obtained in this survey, the Working Age Population (PET) [Acronym in Spanish.] was of 8.9 million people and the Economically Active Population (PEA) [Acronym in Spanish.] was of about 5.0 million people, with a Global Rate of Participation of the PEA (PEA/PET) of 56.1%.

With regard to the Working Population (PO) [Acronym in Spanish.], during the survey it was of 4.8 million people, which meant a Specific Working Rate (PO/PEA) of 96.9%.

With regard to the PO per branch of economic activity, during the analyzed period the highest participation belonged to Agriculture with 38.3%; followed by Commerce with 23.0%; while the Industry participated with 13.6%. The three mentioned branches of economic activity represent, in conjunction, 74.9% of the total.

With regard to the Visible Sub-employed Population (PSV) [Acronym in Spanish.], during the referred period it reached 0.8 million people, which means a Visible Sub-employed Rate (PSV/PEA) of 16.3%.

On the other hand, the Total Open Unemployed Population (PDAT) [Acronym in Spanish.] was of 0.2 million people, with a Total Open Unemployment Rate (PDAT/PEA) of 3.1%.

It is important to highlight that the ENEI [Acronym in Spanish.] is an important progress in the production of the country's economic statistics and that, as it continues to be systematically performed, it will allow its users to carry out more profound analysis about the employment and national economic activity.



C. FISCAL SECTOR

1. Analysis of the budgetary execution

According to preliminary data of the *Ministerio de Finanzas Públicas* -MFP- [Equivalent to the Department of the Treasury] the financial status of the central government to November (latest information available) registered a fiscal deficit of Q1,872.1 million, higher in Q642.9 million (52.3%) than the one registered to November 2004.

The fiscal income to November were of Q22,472.0 million, higher in Q1,797.9 million (8.7%) than the ones observed during the same period of the previous year, which represent a fund raising of 89.8% with regard to the budget for 2005 (92.7% in 2004). Q21,232.0 million were received as tributary income, higher in Q1,765.6 million (9.1%) than the one registered during the same period of the previous year. Said growth is explained by the high fund raising of direct taxes (Q1,196.0 million) and indirect taxes (Q569.6 million).

The growth in fund raising of direct taxes of about Q1,196.0 million (26.1%) is mainly due to the high income obtained from the Income Tax -ISR-, with Q4,117.3 million, higher in Q1,018.5 million (32.9%) than the registered in November 2004. This high fund raising can be associated, mainly, with the implementation of the Institutional Strategic Plan of the *Superintendencia de Administración Tributaria (SAT)*, which considers to combat corruption, to improve the service to contributors and to promote the development and use of computer applications; as well as by the legal reforms in the levied matter approved by the Congress of the Republic on the mid of 2004³⁶.

With regard to indirect taxes, their increase (3.8%) was mainly due to the high fund raising of taxes on the distribution of alcoholic beverages and beers, which was of Q334.1 million, higher in Q139.4 million (71.6%) with regard to the one observed to November 2004. Regarding other indirect taxes, the income per royalties, that register the resources that the government receives from the exploration and exploitation of petroleum, was of Q477.0 million, higher in Q107.3

³⁶ In force since July 1 2004, through Decree Number 18-04 of the Congress of the Republic reforms were established to the Law of the Income Tax which consider the enlarging and reorganization of the taxable base and fund raising of levied types, as well as the creation of mechanisms that simplify the fund raising and avoid defraudation and tributary evasion.



million (29.0%) with regard to November of the previous year. On the other hand, the tax on vehicle traffic registered a fund raise of Q315.8 million, higher in Q51.3 million (19.4%) with regard to the amount observed in the same period of the previous year.

With regard to the expenses made to November, these registered a total of Q24,344.1 million, higher in Q2,440.8 million (11.1%) than the one observed in the same period of the previous year, which represents a budgetary execution of 81.9% for 2005 (in 2004 the execution during the same period was of 74.9%).

The operational expenditures were of Q17,128.7 million, higher in Q1,376.0 million (8.7%) than the ones obtained during the same period of the previous year. In this behavior, the current transferences stand out with a rate of Q6,217.8 million, higher in Q740.9 million (13.5%) than the one obtained in the same period of the previous year; standing out the ones made to public entities, which register a rate of Q2,813.3 million higher in Q357.1 million (14.5%) than the one obtained in the same period of the previous year. With regard to the operational expenditure, it registered a total of Q8,184.7 million, higher in Q277.8 million (3.5%) than the one registered to November of the previous year; standing out the high expenditures made on goods and services of Q286.4 millions. On the other hand, the payment of interest and commissions of the public debt was of Q2,726.2 million, higher in Q357.3 million (15.1%) than the one registered in the same period of the previous year.

The expenditures of capital were of Q7,215.4 million, higher in Q1,064.8 million (17.3%) than the ones registered in the same period of the previous year, registering an execution of 77.9% of the expenses budgeted for 2005 (58.4% in 2004). Said result was determined by the major expenses on indirect and direct investment, which registered a rate of Q5,363.5 million and Q1,851.9 million, respectively, higher than the ones observed to November 2004 in Q833.9 million (18.4%) and Q230.9 million (14.2%), respectively.

With regard to the financing of deficit registered to November, the net domestic financing was of Q2,878.9 million, as a result of the trade of bonds of Q4,316.0 million and expirations of Q1,437.1 million. The net foreign financing reached a negative rate of Q369.9



million, as a result of the disbursement of loans of Q914.6 million and amortization of Q1,284.5 million. Consequently, the fiscal cash registered an increase of Q636.9 million.

CENTRAL GOVERNMENT
BUDGETARY EXECUTION TO NOVEMBER
YEARS 2004 - 2005
-In million of quetzales-

CONCEPT	2004	2005	VARIATIONS	
			ABSOLUTE	RELATIVE
I. Income and Donations	20,674.1	22,472.0	1,797.9	8.7
A. Income	20,389.5	22,226.2	1,836.7	9.0
1. Current income	20,388.9	22,225.3	1,836.4	9.0
a. Tributary	19,466.4	21,232.0	1,765.6	9.1
i. Direct taxes	4,585.6	5,781.6	1,196.0	26.1
ii. Indirect taxes	14,880.8	15,450.4	569.6	3.8
b. Non-tributary	922.5	993.3	70.8	7.7
2. Capital income	0.6	0.9	0.3	50.0
B. Donations	284.6	245.8	-38.8	-13.6
II. Total of Expenses	21,903.3	24,344.1	2,440.8	11.1
A. Operation	15,752.7	17,128.7	1,376.0	8.7
1. Of Operation	7,906.9	8,184.7	277.8	3.5
2. Transferences	5,476.9	6,217.8	740.9	13.5
3. Interests per Debt	2,368.9	2,726.2	357.3	15.1
B. Capital	6,150.6	7,215.4	1,064.8	17.3
1. Direct investment	1,621.0	1,851.9	230.9	14.2
2. Indirect investment	4,529.6	5,363.5	833.9	18.4
III. Fiscal Deficit or Surplus	-1,229.2	-1,872.1	-642.9	52.3
IV. Saving in Current Account	4,636.2	5,096.6	460.4	9.9
V. Financing (A+B+C)	1,229.2	1,872.1	642.9	52.3
A. Net Foreign Financing	2,947.9	-369.9	-3,317.8	-112.5
B. Net Domestic Financing	1,910.2	2,878.9	968.7	50.7
1. Bond negotiation	3,438.1	4,316.0	877.9	25.5
2. Expiration of bonds	1,527.9	1,437.1	-90.8	-5.9
C. Cash variation (-Increase+Decrease)	-3,628.9	-636.9	2,992.0	-82.4

SOURCE: *Ministerio de Finanzas Públicas.*

22. PUBLIC DEBT

a) Domestic

The balance of the public debt to November, according to preliminary data, was of Q16, 683.3 million, higher in Q3,842.5 million³⁷ (29.9%) than the balance observed in December 2004. This increase was mainly due to the negotiation of Treasury Bonds with private, banking and public sectors; in effect, each of

³⁷ Said variation is the result of negotiations of public titles of Q5, 279.7 million and maturity of Q1,437.1 million.



them increased their possession of values in Q2,109.7 million (38.1%), Q892.5 million (32.3%) and Q101.2 million (2.6%), respectively. On the other hand, the non-resident sector reduced its investment in Q224.6 million (31.7%). It is important to indicate that to November 30, 2005, the *Banco de Guatemala* registers possession of Treasury Bonds, which due to the decision contained in the Organic Law of the *Banco de Guatemala*, the state of Guatemala, through the *Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury], is in charge of covering the net deficiencies that the *Banco de Guatemala* could have in each accountant exercise. In that context, on August 29, 2005 the *Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury] for the first time fulfilled said legal mandate, transferring an issue of Treasury Bonds of Q963.7 million to cover the net deficiencies that correspond to the year 2003 to the *Banco de Guatemala*.

Regarding the structure of the domestic debt balance per possessor, this varied as a result of the major negotiations carried out with the private and banking sectors and the possession of values by the *Banco de Guatemala*. In effect, to December 31, 2004 the participation of said sectors was of 43.1%, 21.6% and 0.0%, respectively, while to October of the current year it was of 45.8%, 21.9% and 5.8%, respectively. In contrast, the public and non-resident sector reduced their relative participation from December 2004 to November 2005, going from 29.8% and 5.5% to 23.6% and 2.9%, respectively.

Central Government
Balance of the Public Domestic Debt
Years 2004 - 2005
- In million of quetzales and in percentages -

Possessor	To 31/12/2004	Structure	To 30/11/2005	Structure	Variation	
					Absolute	Relative
Total	12,840.8	100.0	16,683.3	100.0	3,842.5	29.9
<i>Banco de Guatemala</i>	0.0	0.0	963.7	5.8	963.7	100.0
Banking sector	2,767.1	21.6	3,659.6	21.9	892.5	32.3
Public sector	3,826.9	29.8	3,928.1	23.6	101.2	2.6
Non-resident sector	708.5	5.5	483.9	2.9	-224.6	-31.7
Private sector	5,538.3	43.1	7,648.0	45.8	2,109.7	38.1

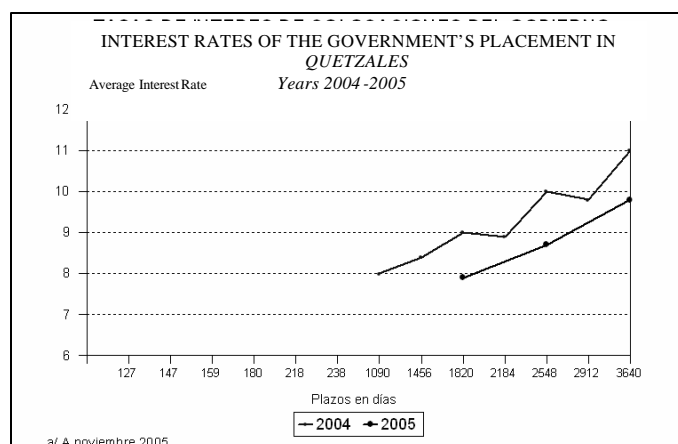
SOURCE: Section of values, *Banco de Guatemala*.



Regarding the term of placement of debt, it is important to indicate that in 2004 the weighted average of placements in *quetzales* was of 2,067 days; while to November 2005 was of 3,051 days. With regard to the placement of Treasury Bonds in US dollars, there were no negotiations from January to November of the present year; the weighted average term of the negotiations carried out in 2004 was of 2,076 days.

The weighted average interest rate of the government's placements in *quetzales* was of 9.13% in 2004, while to November of the present year was of 9.22%.

Graph No. 52



b) Foreign

According to preliminary data, to November 2005 the balance of the foreign public debt³⁸ was of US\$3,716.4 million, lower by US\$125.1 million than the balance to December 2004. Said reduction is the result of disbursements of US\$119.2 million, amortizations of US\$177.9 million and a reduction of the accounting balance of US\$66.4 million derived from the appreciation of the American dollar regarding other currencies that integrate the account units in which some loans are denominated. Therefore, the net resource transferences, understood as the result of the difference between the disbursed resources and the amortization of capital, was negative in about US\$58.7 million.

Regarding disbursements due to loans made to the Central Government in said period, as creditor, stand out the ones provided by the *Banco Centroamericano de Integración Económica -BCIE-* (Central American Economic Integration Bank) of US\$45.2 million, *Banco Internacional de Reconstrucción y Fomento -BIRF-* (International Reconstruction and Development Bank) of US\$29.5 million and Inter-American Development Bank -IDB- of US\$28.0 million. Regarding the amortization of capital the ones made to the Inter-American Development Bank -IDB- of US\$54.9 million and to the *Banco Centroamericano de*

³⁸ Does not include the balance of the foreign debt of the *Banco de Guatemala*, which on November 30, 2005 was of US\$1.8 million.



Integración Económica -BCIE- of US\$43.5 million stand out. Regarding the payment of debt interest, the ones that belong to the bonds negotiated abroad - EURO BONOS- of US\$100.6 million stand out.

3. Closing Estimation to December 2005

According to estimations of the *Ministerio de Finanzas Públicas* [Equivalent to the Department of the Treasury], the budget closing for 2005 considers that the fiscal deficit would reach a level of about 1.5% of the GDP, while the tax burden will be of about 10.0%, similar to the one registered in 2004. It is important to highlight that said deficit includes the increase foreseen in the public expense for 2005, derived from the reconstruction of the damages caused by tropical storm *Stan*.

D. STABILITY OF THE FINANCIAL SYSTEM

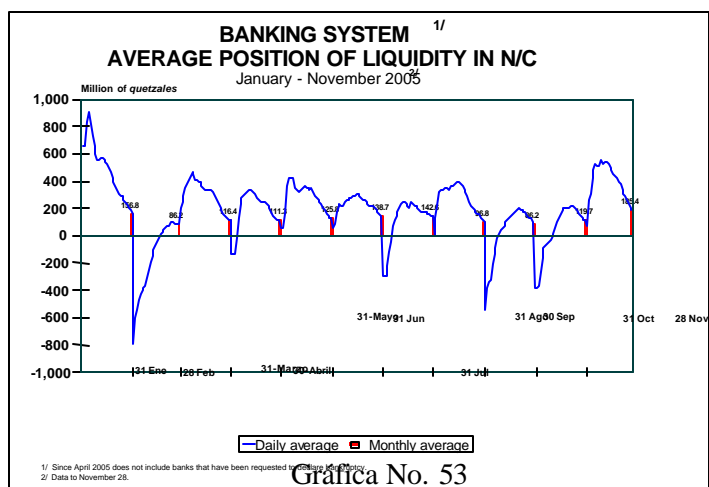
1. Stability Indicators

a) Banking liquidity

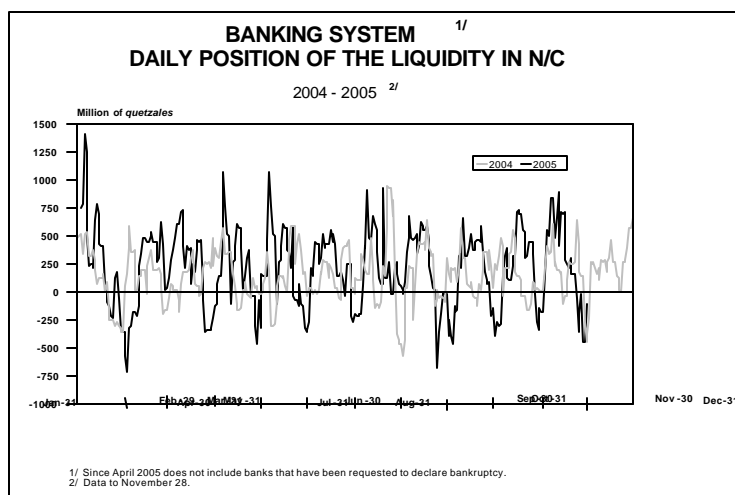
i) In national currency

The banking liquidity, measured by the surplus and deficiencies of cash, helps to determine the amount of financial resources of immediate availability in the banking system. During most part of the January-November 2005 period, the banking system showed, as an average, positive and moderate rates of liquidity. In effect, said variable was between Q86.2 million (in February and September) and Q185.4 million in November.

On the other hand, the daily liquidity that banks registered from January to November 2005 also showed stability regarding the behavior observed during the previous year. With that in mind, from January to November of the current year, the annual daily average liquidity was of Q 124.1 million, while in 2004, the same annual average reached Q155.1 million.



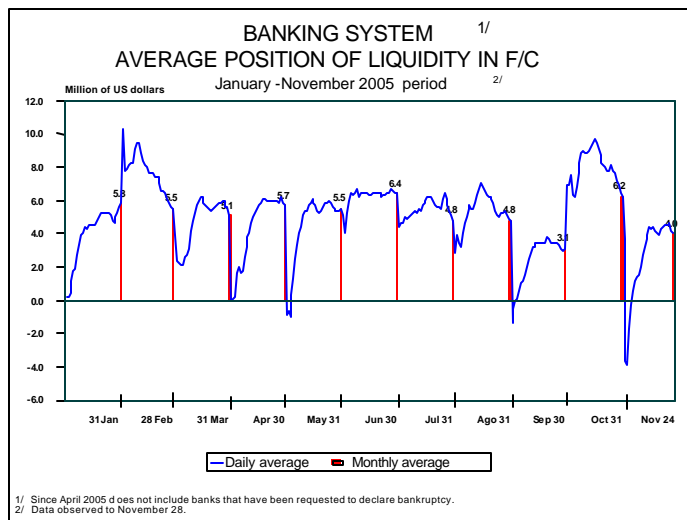
Graph No. 54





The moderate and stable behavior of the banking liquidity rates during 2005 are mainly associated with the high volume of resources channeled toward the credit to the private sector, as well as to the increase of the bank's investment in governmental titles.

Graph No. 55

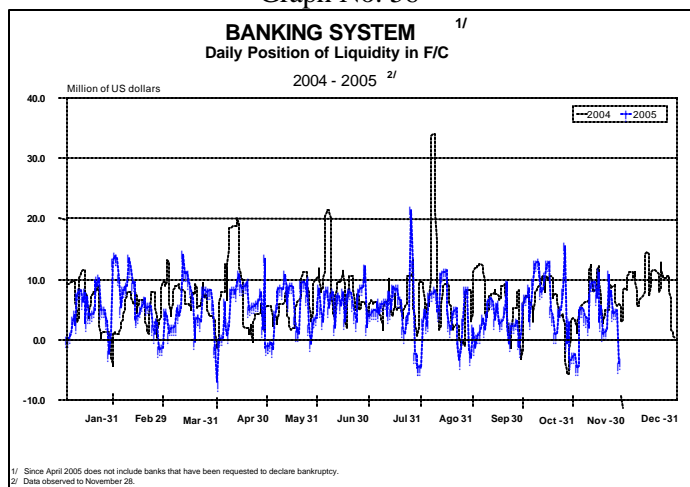


ii) In foreign currency

The average banking liquidity in foreign currency, during the January-November 2005 period, was situated, as an average, between US\$3.1 million (September) and US\$6.4 million (June). To November 28, 2004 it was of US\$4.0 million.

The daily liquidity in foreign currency, during 2005, registered a relatively stable behavior, similar to the one observed in the previous year, registering its lower point on March 31 (-US\$7.1 million) and its peak on July 25 (US\$21.5 million).

Graph No. 56



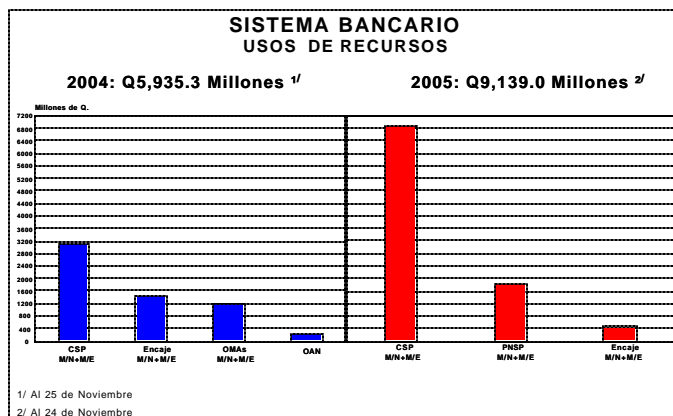
The behavior observed in the banking liquidity rates, in foreign currency, during 2005 is somehow associated with the fact that the available resources have been mainly transferred to the granting of credit in foreign currency, because the same has increased during the referred period in about Q876.8 million.

2. Sources and use of the funds of the banking system

To November 24, 2005 the banking system was obtaining resources from other sectors of the economy in order to carry out its role of financial intermediation for an amount of Q9,139.0 million, during the same period of the previous year they were of Q5,935.3 million.

As it is shown in the graph, to November 2005 the main source of funds of the banking system was

Graph No. 58
Banking System
Use of Resources



constituted by the total fund raising of deposits from the public (in national and foreign currency) of about Q7,413.9 million, by the net credit obtained abroad of Q1,028.8 million and by the disinvestment in LTDs of the *Banco de Guatemala* of Q199.8 million. On the other hand, in 2004 the main sources of funds were the total fund raising of deposits from the public (in national and foreign currency) of Q4,820.8 million, the amortization obtained from the credit granted to financial institutions of Q440.5 million, the reduction of the net financing granted to the public sector (investment minus deposits) of Q387.4 million and net credits obtained abroad of Q286.6 million.

Regarding the use of said resources from the banking system, as shown in the following graph, in 2005 the same were mainly designated to grant credit to the private sector in national and foreign currency of Q6,865.3 million, to the net financing granted to the public sector (investments minus deposits) of Q1,819.1 million and to the increase of the bank cash in national and foreign currency of Q454.6 million. On the other hand, in 2004 the use of Q5,935.3 million were mainly used to grant credit to the private sector of Q3,089.7 million, to increase its cash account in national and foreign currency of Q1,438.1 million and to make investment in LTDs of the *Banco de Guatemala* of Q1,187.9 million.

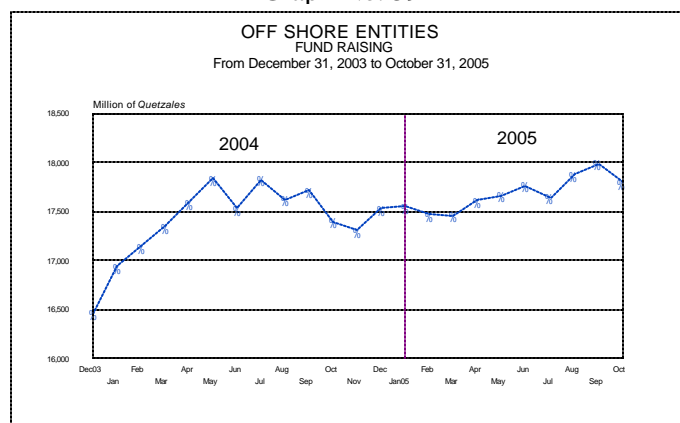
3. Off shore entities

Although the information about the off shore entities is still limited, the available data permits, in a general manner, to carry out an analysis of its operations and financial solvency in a disaggregated way. For that reason, based on the information to October 31, 2005, the following analysis can be deduced from its main asset and liability operations and liquidity indicators:

a) Fund raising

The fund raising from the off shore entities to October 31, 2005, registered a rate equivalent in *quetzales* of Q17,786.4 million, with a growth of Q254.2 million (1.4%) with regard to the balance registered on December 31, 2004. It is important to mention that by the end of 2004, the fund raising of the

Graph No. 59

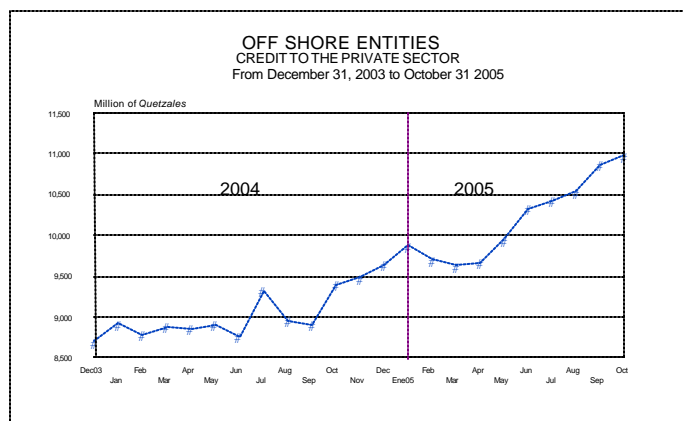




off shore entities represents a 30.7% of the total fund raising of the national banking system, while to October 31, 2005, said proportion was of 27.5%.

b) Credit to the private sector

Graph No. 60



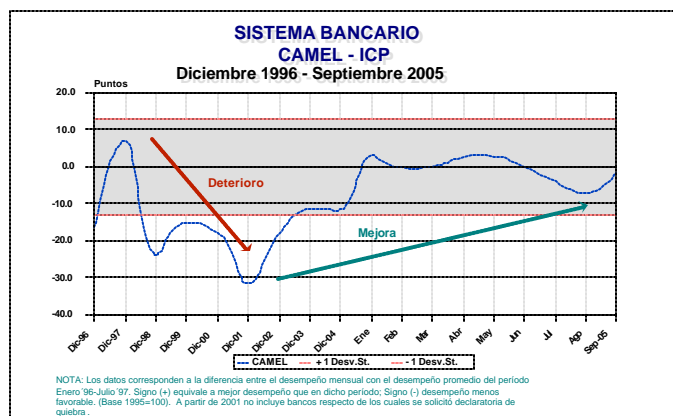
The credit granted by the off shore entities to the private sector, to October 31, shows a balance equivalent in *quetzales* to Q10,982.5 million, which is higher in Q1,340.9 million (13.9%) than the one registered to October 31, 2004. It is important to indicate that by the end of the previous year, the credit granted by the off shore entities to the private sector represents 23.4% of the total granted to the national banking system, while to October 31, 2005 said proportion was of 24.2%.

4. Early alert system

The performance of the national banking system in 2005, measured through the CAMEL-ICP indicator³⁹ evidencing better behavior of the system regarding December 2004. In effect, to September 30, 2005 said indicator was at -1.47, number significantly higher to -11.65 observed in December 2004. It is worth indicating that the values pointed out earlier have as a base of comparison the observed aggregate for the banking system during the period of January 1996 to July 1997, in which the banking system registered normal performance. In order to obtain a better appreciation of the content of the indicator, an evaluation for each of its components is presented as follows:

The indicator of capitalization, that measures the financial solvency, is adequate for capital of the entities to cover the risk exposition with their own resources to the risk derived of the asset operations held. Said indicator is built based on the assets and contingencies

Graph No. 61
Banking System
CAMEL-CPI



³⁹ Within the early alert systems used by the central banks for the macroeconomic analysis of the financial system is included the aggregate model CAMEL (*Capital, Assets, Management, Earnings y Liquidity*) adjusted by a Problem Portfolio Indicator –ICP-(for its acronym in Spanish) which constitutes a risk indicator of the portfolio for each institution within the system. The aggregate model CAMEL-ICP allows evaluating the performance of the financial institutions, in function of indicators that measure capitalization (C), the quality of the most important asset which is the credit portfolio (A), the administrative operation (M), the real profitability (E) and the liquidity (L); as in the function of the structure of the portfolio in risk at the individual level and of the system as a whole and the coverage of the same. As to the interpretation of this indicator, the greater the aggregate, the better the performance of the system.



subject to law for minimal requirements of capital regarding computable capital. Regarding, the period under study; the value of the indicator decreased by 14.50% in December 2004 to 13.88% in September 2005. In this case, the assets and contingencies subject to the minimum requirements of capital have shown a greater dynamism in their growth during the year. In effect, whereas the assets grew by 11.86%, the computable capital grew by 7.07%. It is necessary to point out that even though there is a decrease in the indicator of capitalization, this continued locating itself over what is demanded by the prudential normative, which fixed the minimum requirement of capital in 10% regarding the assets and contingencies subject to the requirement.

The quality and the asset measured through the coefficient that relates the sum of the expired portfolio and the portfolio in default (contaminated portfolio) regarding the total of the gross credit portfolio (including provisions) register a marginal deterioration when surpassing 5.79% in December 2004 to 5.99% in September 2005. When disaggregating the components of the indicator, could establish that the behavior observed is fundamentally explained by a slight increase of the portfolio in default.

In order to measure the administrative operation an approximation between the annualized administrative expenses regarding the net average total assets (excluding provisions, depreciations and amortizations) are used. In this indicator an improvement is evidenced when surpassing 4.4% in December 2004 to 4.25% in September 2005. Said behavior is mainly explained because the administrative expenses proportionally have grown less than the average assets, which evidenced an improvement in the administrative operation on behalf of the financial system.

The real profitability indicator expresses the yield of the patrimony of the entities during the period. For the effect, the reason is considered within the net profits (after taxes) annualized regarding the average accountable capital, minus the inflationary rhythm. This measure allows evaluating the sustainability in the long term of the patrimony to the entities. During the period from December 2004 to September 2005, the real profitability increased considerably when going



from 5.15% to 9.78%, respectively. Said behavior is fundamentally explained by the income from the placements (credit, investment and operations in foreign currency), which represented 88.6% of the total income to September 30, 2005.

An adequate management of banking liquidity allows the entities to face the obligations in short term without incurring in unnecessary costs. One measure of this indicator is obtained through the reason between the availability and the total deposits. During the period, the indicator shows a slight deterioration when going from 22.52% in December 2004 to 21.11% in September 2005.

In synthesis, the global improvement in the added indicator CAMEL-ICP fundamentally obeys the favorable behavior showed by the indicators of real profitability and the administrative operation, which reflects the advances of the banking system, in the context of the structural reform of the financial sector of the country. This result was not greater due to the lesser performance of the indicators of asset, capitalization and liquidity quality.

5. Advances in the process of strengthening the national financial system

a) Strengthening of the banking system

In resolution JM-93-2005, dated May 18, 2005, the Monetary Board issued the new regulation for the Administration of Credit Risk, that has as an objective regulating the relative aspects to the credit process, to the minimum information of the petitioners of financing and of the debtors and of the valuation of the credit assets themselves that the banks must observe, the off shore entities and the businesses of financial groups that grant financing.

On their part, the Congress of the Republic, in Decree number 58-2005 dated August 31, 2005 approved the “Laws to prevent and repress financial terrorism”, that has as its objective adopting measures for the prevention and repression of financial terrorism, complementary to the regulation against money and other assets laundering. With this law the welfare and security of the inhabitants of the Republic and their



assets are safeguarded, giving fulfillment to the assumed commitments for Guatemala in the International Convention for the Repression of Financial Terrorism and their requirements are attended and the standards dictated by the International Organisms specialized in the matter; which allows guaranteeing and giving certainty and improving the normative so the financial system in the country operates.

In resolution JM-92-2005, dated May 18, 2005, the Monetary Board issued the Regulation for Investments of the Banking System in Values Titles issued by Private Entities. Said instrument establishes the requirements that the banks of the system must observe prior to investing in titles of that nature being offered to the public in the stock exchange and non stock exchange markets, according to the Law of Values and Commodities Markets, Decree Number 34-96 of the Congress of the Republic. Also, it establishes that the referred values titles that are negotiated in international markets, must count on the qualification granted by Standard & Poor's or an equivalent qualification granted by a recognized risk qualifier of international prestige; and, the issues that are negotiated in the national market, that should accredit the qualification of local risk, granted by a qualifying risk business that is found registered in the Registry of Values and Commodities Market.

Also, in Decree Number 72-2005 dated October 13, 2005, the "Reform to Decree Number 2-70 of the Congress of the Republic, Commerce Code of Guatemala", was approved; adding an article for which we recognize the validity of the copies of the original checks issued to be cashed in foreign banks and that, due to the fact that they were not paid, have to be returned to Guatemalan banks to be delivered to their beneficiaries. The objective of this reform is to make for the interested party to present the legal corresponding actions, possible using the copies of original checks for that effect.



b) Strengthening of the financial security net

The Monetary Board through resolution JM-50-2005, dated March 2, 2005, decided to authorize, for the effects of the established in the first paragraph of article 48 of the Organic Law of the *Banco de Guatemala*, case per case, the last instance credit petitions formulated by the national private banks to solve temporary deficiencies of liquidity. Also, approved the procedure that generally and uniformly must be observed for the granting of last instance credits, with the purpose, on the one hand, that the presented petitions be taken care of with the necessary promptness, and on the other hand, that the banking institutions know the requirements that they must fulfill in order to obtain said financing.

c) Modernization of the Payments system

Within the modernization process of the Payments System, the Central Bank, based on the Modernization matrix of the Payment System, approved in resolution JM-140-2004 dated November 17, 2004, continued developing the tendency activities to achieve the strengthening of the National Payments System, taking into account the Basic Principles for the Payment System Importance, developed by the Bank of International Settlement (BIS).

The *Banco de Guatemala*, according to the established activities in the referred matrix and according to article 5 of the Regulations of the Banking Compensation Chamber, approved by the Monetary Board in Resolution JM-51-2003, dated August 12, 2005 handed over the administration of the Banking Compensation Chamber of the Banking Association of Guatemala, who at the same time hired *Imágenes Computarizadas de Guatemala, Sociedad Anónima* – (Computerized Images of Guatemala, Stock Company) –ICG-, to exercise the function of Main Compensator, responsible for the coordination process of electronic check compensation and of establishing the net multilateral result of said process for its corresponding liquidation in the float accounts that the participating banks have constituted in the *Banco de Guatemala*. Said chamber of compensation, with the administrative scheme of a private enterprise and under the general



supervision of the *Banco de Guatemala*, began operations on August 16, 2005. The referred change allows the country to adopt better international practices in this matter, since it is based on international standards and uses modern technological tools, which emphasized the minimization of financial, operative, legal and functional risks in general, facilitating the transactions and funds mobility.

Additionally, the Monetary Board in resolution JM-166-2005, dated November 30, 2005, approved the regulation of the Gross Liquidation System in Real Time –LBTR (for its acronym in Spanish) which gives support for the issue of norms and manuals of procedure and other applicable instructions for the same, and for said system to begin operations at the beginning of January 2006. It is worth indicating that through this system, the banks, financial companies, stock exchanges, public entities and other economic agents will liquidate their transactions in gross and real time form, as well as in national or foreign currency. The operations that the participants could make in the system are the following: funds transfer; liquidation of the investments with values titles issued by the Government of the Republic and the Term deposits constituted in the *Banco de Guatemala*; instructions for numerous withdrawals; liquidation of the result of bilateral and multilateral compensations; operations on behalf of the public sector; liquidation of operations under cash on delivery and payment against payment; payment for commissions for services rendered in the system; consultations and generation of archives; elaboration and generation of reports and statistical information; and others authorized by the *Banco de Guatemala*.

With the purpose of making and liquidating the previous operations, the LBTR system will interact with the internal systems of the *Banco de Guatemala* that affect the accounts of monetary deposits constituted in the Central Bank. Said internal systems are: Accounting and Financial Information System SICOF-; Till System; and Value Titles System –SITV-. Also, the design of the operation of the LBTR system, is used to endow the use of the two communication nets, a local net (*Bancared*) and an international net (SWIFT) that uses standard formatting messages of SWIFT.



On the other hand, it is also foreseen that the referred system will connect with negotiation and compensation systems developed by private enterprise, such as, Banking Compensation Chamber, Electronic Banking Table of Money -MEBD-and the Automatic Compensation Chamber -ACHs-, administrated by the Banking Association of Guatemala, as well as the Electronic Negotiation of Foreign Currency System -SINEDI- and the Electronic Liquidation System –SEL-administered by the National Stock Exchange, Stock Company, due to the fact that said systems make transactions of high or low value in the financial system, which are liquidated currently using as payment instruments the check, instructions for payment by coded fax and instructions for payment in writing.